THE INTERNATIONAL INSOLVENCY & RESTRUCTURING REVIEW 2021/22

Beaumont Capital Markets

The International Insolvency & Restructuring Review 2021/22

Content

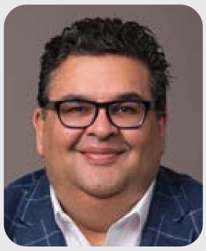
INSOLVENCY & THE COVID-19 PANDEMIC: LIVES & LIVELIHOODS

In addition to ushering in a public health crisis, the COVID-19 pandemic has carried with it profound economic effects and has sent shockwaves through global financial markets. Reductions to labour market participation and productivity rates have interrupted supply chains, slowing many domestic manufacturing sectors to a halt. The IMF estimates that global outputs have fallen by 3.5 percent in 2020 alone.[1] Similarly, the rise in unemployment rates and health-related absenteeism has reduced household wealth, diminished shared prosperity, and, as a recent World Bank analysis suggests, pushed an estimated 88 to 115 million people into extreme poverty.[2] At the same time lockdowns, business closures, and social distancing directives have also exacerbated demand-side disruptions, leading to a decrease in household consumption, lost business incomes, and the threat of liquidity shortfalls for individuals and corporates alike. The COVID-19 crisis has markedly diminished actual and expected sales and profits for many businesses and sectors, potentially putting downward pressure on the value of firms' assets and leading to a decline in equity. Unresolved uncertainties about the pandemic's duration, magnitude, and impacts threaten to further dampen consumer, investor, and lender confidence, and may lead to a reduction in the availability of credit for many distressed businesses.

This confluence of negative trends has posed a formidable challenge for policymakers looking to confront some of the pandemic's worst economic effects. While countries confront similar types of economic fallout, the joint World Bank/INSOL International COVID-19 Reform Tracker demonstrates that governmental responses have varied in degree and type in the insolvency space. Many higher-income governments have implemented fiscal stimulus initiatives, forbearance policies and direct legal interventions in their domestic insolvency systems aimed toward hastening recovery efforts. These short-term mechanisms include temporary changes to creditor rights, suspension of the duty to file for insolvency and related liabilities, increased barriers for creditor-initiated filings, emergency debt enforcement freezes, and suspension of insolvency-related judicial proceedings. Some policymakers have even had the foresight to tailor their insolvency reforms and financial supports to small entrepreneurs and micro, small, and medium sized enterprises (MSMEs). This includes simplified procedures and amended timelines for MSMEs, measures in line with the World Bank's newly released MSE Principles. Most of the measures outlined above share an essential feature: The recognition that preventing viable businesses from being forced to exit the market prematurely and providing distressed firms with temporary enforcement protections could help them to find their financial footing and avoid insolvency altogether.

[1] https://www.imf.org/en/Publications/WEO/Issues/2021/01/26/2021-world-economic-outlook-update

[2] https://www.worldbank.org/en/news/press-release/2020/10/07/covid-19-to-add-as-many-as-150-million-extreme-poor-by-2021



Mahesh Uttamchandani

Global Manager for Financial Inclusion & Infrastructure in the World Bank Group.

In this role, he manages the WBG's global work on Payment Systems, Digital Financial Services, Responsible Financial Access and Insolvency.

Mahesh is the Chair of the International Committee on Credit Reporting and oversees the Insolvency & Creditor Rights Task Force. He is also a board member of INSOL International and a member of the Executive Committee of the Consultative Group to Assist the Poor (CGAP).

Mahesh joined the WBG's Legal Vice Presidency in 2006 and has since held various positions at both the World Bank and International Finance Corporation. He previously worked at the European Bank for Reconstruction and Development and as an insolvency litigator at a leading Canadian law firm. He has published and taught at the university level and lectured extensively in North America, Europe, Africa and Asia.

> Some policymakers have even had the foresight to tailor their insolvency reforms and financial supports to small entrepreneurs and micro, small, and medium sized enterprises.

In emerging economies, a gap presently remains between the need and the ability of governments to respond. As the global economic slowdown continues, this gap is likely to widen if reforms and supports are not put in place. Policymakers in lower-income countries often lack the financial means and practical expertise to develop effective insolvency regimes, a factor that may put them at a significant competitive disadvantage in the post-pandemic global economy. The development of strong insolvency and creditor/debtor rights (ICR) regimes ameliorates many of the economic challenges presently faced by firms through increased credit availability, job preservation through successful reorganisation and business rescue, and improved creditor returns, among many other complimentary effects. Where robust ICR legislation does already exist in these countries, it is often not fully operationalised and considerable barriers exist to prevent governments from using these laws as effective economic recovery tools. Insolvency systems in emerging markets remain mired with challenges, as evidenced by low creditor recovery rates when compared to those in advanced economies. It is crucial that governments turn their attention towards the reform and implementation of effective domestic ICR regimes. Doing so will contribute to a pandemic recovery effort that preserves pre-COVID development advancements, safeguards viable businesses, protects vulnerable individuals, and builds more resilient economies.

Swift and decisive policy responses by governments helped many businesses bridge short-term liquidity shortfalls during the first year of the COVID-19 crisis. Despite this impressive record of policy responses implemented by governments around the world, significant work remains in the months ahead if we are to prevent the pandemic's economic shocks from translating into enduring system-level risks. Early evidence suggests that the worst is yet to come— with a wave of solvency issues, debt defaults, and non-performing loans looming on the horizon as payment holidays and stimulus programs come to an end in many jurisdictions.[3] Future fiscal and economic policy responses must be undertaken with a deep understanding of the present financial reality faced by individuals and businesses, but also with an eye to the future and post-pandemic economies. Part of a successful response will necessarily involve temporary changes and permanent improvements to a country's domestic insolvency regime. ICR regimes provide policymakers with a helpful array of tools to flatten the curve of crisis-related insolvencies and lessen the risk of debt-overhang, both of which could slow down the speed of recovery if left unchecked. Long-term recovery and economic growth trajectories will be affected by the choices and measures countries make now. These are important initiatives— lives and livelihoods might hang in the balance.

Swift and decisive policy responses by governments helped many businesses bridge short-term liquidity shortfalls during the first year of the COVID-19 crisis.

[3] http://documents1.worldbank.org/curated/en/962221615273849133/pdf/The-Calm-Before-the-Storm-Early-Evidence-on-Business-Insolvency-Filings-After-the-Onset-of-COVID-19.pdf

KEY DEVELOPMENTS & THE LATEST TRENDS IN THE BAHAMAS – FROM A LEGAL PERSPECTIVE

The insolvency legislation in The Bahamas

In 2011 and 2012 the insolvency legislation in The Bahamas was completely revamped by the enactment of the following Act and Rules:

(i) The Companies (Winding Up Amendment) Act, 2011;
(ii) The International Business Companies (Winding Up Amendment) Act, 2011;
(iii) The Companies Liquidation Rules, 2012 (the "**CLR**");
(iv) The Insolvency Practitioners' Rules, 2012; and
(v) The Foreign Proceedings (International Cooperation) Liquidation Rules, 2012.

The procedure for the liquidation of companies incorporated under the Companies Act of 1992 (as amended by the Companies (Winding Up Amendment) Act, 2011, the "**Companies Act**") and under the International Business Companies Act of 2000 (the **"IBC Act"**) is now almost identical in that section 89 of the IBC Act (as amended) states that "*[a] company incorporated under this Act may be wound up under any of the circumstances, insofar as they are applicable to a company incorporated under this Act, in which a company incorporated under the Companies Act, Ch. 308 may be wound up and subject to the provisions of this Part the provisions of the Companies Act relating to winding up and dissolution shall apply mutatis mutandis to the winding up and dissolution of the company*". Accordingly, the CLR apply to both types of company.

Section 205(3) of the Companies Act divides the powers necessary to carry out the duties and functions of an official liquidator into those which may only be exercised with the sanction of the court (specified in Part I of the Fourth Schedule) and those which may be exercised either with or without such sanction (specified in Part II of the Fourth Schedule). If the sanction of the court is required, the official liquidator would make a sanction application under CLR Order 11. CLR Order 24, rule 9 deals with the costs of a sanction application.

There are currently before the Supreme Court of The Bahamas two insolvency cases dealing with those matters and with liquidation committees, which were also introduced by the CLR.

Recent judicial decisions

A. In the matter of Rural International Bank Limited – 2013/COM/bnk/0088

This case dealt with the question as to whether the professional fees and expenses charged by counsel to the liquidation committee of Rural International Bank Limited (In Liquidation) (the "**Committee**") should be paid out of the assets of the company as an expense of the liquidation under CLR Order 9, rule 5(3) on the basis that they had been reasonably and properly incurred.

Beatrice E. Miranda
Partner

Qualified Swiss attorney admitted to the Bar of Zurich. She has also been admitted as a Solicitor of the Supreme Court of England and Wales and is qualified to practice law in The Bahamas. Beatrice is also a member of STEP.
She has worked around the world in Switzerland, Australia and The Bahamas. Her work has an international element with clients in The Bahamas, South America, North America and Europe. She is fluent in English, German and Spanish, speaks French and also understands Italian and Portuguese. Beatrice has managed complex multi-jurisdictional liquidations for years, working closely with attorneys on different continents. Since August 2020 Beatrice has been working remotely from Switzerland, supporting her clients in the same way as before. Beatrice has built up a very strong reputation and long-lasting relationships with her clients, having worked at McKinney, Bancroft & Hughes for over two decades.

Vanessa L. Smith
Partner

Experienced in trust, insolvency, corporate, commercial, and civil litigation. With the keen ability to maintain open lines of communication, she is a reliable and trustworthy legal ally. Passionate about engaging with others, Vanessa endeavours to understand her clients' objectives to provide the best service possible in an efficient and cost-effective manner. Her clients include high-net worth individuals resident in different jurisdictions and young Bahamian entrepreneurs who seek Vanessa's innovative advice in relation to financial services and corporate matters. Vanessa also advises insolvency practitioners on all aspects of restructuring and insolvency law in The Bahamas and frequently appears before the Supreme Court of The Bahamas in major court-supervised liquidations in the jurisdiction.

Vanessa is a member of the Membership Committee of the Restructuring and Insolvency Specialists Association (Bahamas) and the International Association of Restructuring, Insolvency & Bankruptcy Professionals.

In a Ruling delivered on 16 February 2021 the judge held that, although the engagement letter was not signed by all of the members of the Committee, counsel thereto was nonetheless duly appointed by a valid resolution of the Committee. Unlike in the case of the official liquidator's legal counsel, there is no mandatory requirement of an engagement letter for counsel to the liquidation committee. Although the fees and expenses incurred by counsel to the Committee during a certain period of time were reasonably and properly incurred, so that they ought to be paid out of the assets of the company as an expense of the liquidation, the judge disallowed numerous items which had been questioned by the joint official liquidators in their application for directions.

The judge made no findings with regard to the issue of the parties' costs, which is also contentious and may have to be decided by the court at a later date. This matter will depend, *inter alia*, as to whether the joint official liquidators' application is considered to be an application for directions (as contended by them) or whether it is a sanction application. In the latter case, it is possible that the costs of successfully opposing the application (i.e. the legal fees incurred by outside counsel to the Committee's counsel) would have to be paid out of the assets of the company on an indemnity basis under CLR Order 24, rule 9(4)(a).

B. In the matter of Pacifico Global Advisors Ltd. – 2019/COM/bnk/00077

(i) The official liquidator's first application relating to his costs

In a Ruling dated 17 September 2020 the judge dealt with an application by the official liquidator of Pacifico Global Advisors Ltd. (In Liquidation) for an order sanctioning, *inter alia*, the deduction of a portion of the general liquidation costs from assets which were held in segregated accounts of an investment fund into which the company's clients had invested.

The judge first addressed whether the application by the official liquidator was a sanction application, which had a bearing on which parties had a right of audience. She held that the application was not a sanction application, as the term assets in section 7 of Part I of the Fourth Schedule of the Companies Act (which deals with an official liquidator's power to deal with all questions in any way relating to or affecting the assets or the winding up of the company) did not include assets which did not belong to the company. She also held that the power to defray liquidation costs and expenses was not included in the powers which the official liquidator sought to have sanctioned.

With regard to the right of audience, the judge held that both the receiver and manager over certain sub-funds and the administrator of the investment fund were mandated to liquidate and disburse the assets of the fund and thus had a sufficient interest in the hearing to give them the right of audience. The judge further found that the liquidation committee had the right to be heard on the basis that it was an interested party.

The judge found that the assets held by the company in the segregated accounts had not become trust assets of the company as submitted by the official liquidator. She directed that those assets be released by the company and disbursed in accordance with orders previously made by the court. Consistent with the rule that costs follow the event, the judge ordered the official liquidator to personally bear the other parties' costs.

(ii) The official liquidator's second application relating to his costs

In a Ruling dated 9 March 2021 another judge determined a further application by the official liquidator in the same proceedings. This time, the official liquidator sought an order allowing him to recover general liquidation costs from other assets, which stood in the name of the company, but were held on trust for its clients. The judge allowed the official liquidator to deduct from the trust assets the costs incurred by him which were solely attributable to the identification, realisation, preservation, protection, recovery, distribution and administration thereof, subject to those costs being in accord with the fees which the company would have levied if it had not been placed into liquidation.

However, the judge did not consider the official liquidator's request to also deduct from the trust assets a percentage of the balance of the liquidation costs which were not solely attributable to those assets, as the official liquidator had not identified the specific percentage for the requested deduction. The judge stated that, if he were required to make a determination at this stage, the deduction could not exceed 15% of the trust assets. The judge also denied the official liquidator's request for him, his team and his lawyers to receive a payment on account of costs.

The impact of COVID-19

In response to the COVID-19 pandemic, the Government of The Bahamas declared a state of emergency and rolled out a COVID-19 fiscal stimulus response plan in March 2020.

With a faltering economy in the aftermath of Hurricane Dorian in September 2019 and a temporary shutdown of all businesses with the exception of specific essential services, the 2020/2021 budget effective 1 July 2020 aptly labeled "Resilient Bahamas: A Plan for Restoration" contained a commitment to not increasing taxes.

"Resilient Bahamas: A Plan for Restoration" contained a commitment to not increasing taxes.

To date the Government has implemented, *inter alia*, the following initiatives to assist ailing businesses in the private sector:

- Expansion of unemployment benefits under the national insurance program to self-employed persons although they are not typically eligible to receive such benefits;
- 3-6 month payment deferral program by domestic commercial banks and credit unions against the repayment of loans for businesses or individuals in good standing who were negatively impacted by the pandemic (interest will continue to accrue during the deferral period);
- Business Continuity Loan Program to assist micro, small and medium enterprises with operating costs; loans range from $5,000.00 to $300,000.00 and offer a repayment grace period of 4 months;
- Tax Credit & Tax Deferral Employment Retention Program to aid all qualifying VAT registered businesses with a turnover in excess of $100,000.00 and hotels to provide payroll support and encourage employee retention; and
- Establishment of an Economic Recovery Committee (the "**ERC**") to research and develop strategic recommendations to inform the Government's policies in addressing the impact of the COVID-19 pandemic on the economy.

In its report in the last quarter of 2020 the ERC recommended the modernisation of the insolvency regime in The Bahamas. The ERC's position is that the bankruptcy laws are antiquated, near punitive and non-rehabilitative in that they do not help with the financial recovery of an insolvent individual. While the ERC's opinion is that the insolvency laws governing companies are modern, they are incomplete as they lack a rehabilitative component. Together the insolvency regime results in prolonged hardship for insolvent individuals and the loss of insolvent enterprises. The ERC recommends the following to aid in economic recovery:

- Repeal of the Bankruptcy Act and replacement thereof with a modern insolvency regime for individuals and amendment of the Companies Act to introduce 'corporate rescue' procedures; and
- Suspension of the filing of any bankruptcy proceedings against individuals and compulsory liquidation proceedings against companies for a prescribed period with respect to insolvencies due to the current economic crisis.

While the Government has committed to reviewing the ERC's recommendations, no steps have been taken to amend the current insolvency regime. Currently, there is no restriction on the filing of winding up petitions under the Companies Act. Further, the statutory prescribed minimum of $1,000.00 for a statutory demand against companies has not increased, and it is possible for a winding up petition to be presented against a company which has failed to respond to a statutory demand within 21 days of being served with the same. The Supreme Court of The Bahamas, which has the power to grant a winding up order, is operating as normal, utilising virtual courtrooms via video conferencing platforms.

Directors of companies and business-owners must continue to act cautiously as the "clawback" provision in the Companies Act remains in force and has not been extended or suspended as a result of the COVID-19 pandemic. Accordingly, every transfer of property or charge thereon, payment obligation or judicial proceedings incurred or taken by any company in favour of any creditor at a time when the company is unable to pay its debts with a view to giving that creditor a preference over the other creditors shall be invalid if it occurred within the 6 months immediately preceding the commencement of a liquidation. Furthermore, an official liquidator has two years to commence an action to seek to set aside every disposition made at an undervalue by or on behalf of a company with intent to defraud its creditors.

Director liability for insolvent trading remains an issue despite the COVID-19 pandemic, and company directors must take every step reasonably open to them to minimise the loss to the company's creditors in the event that they know or ought to have known that there was no reasonable prospect that the company would avoid being wound up by reason of insolvency. Directors may incur personal liability for insolvent trading whereby they would be required to make a contribution to the company's assets.

Conclusion

The insolvency jurisprudence in The Bahamas has continued to evolve since the introduction of the insolvency legislation in 2011 and 2012, which courts have grappled with interpreting. The Liquidation Rules Committee is currently considering amendments to the CLR, which are expected to resolve any practical problems which have arisen since the implementation thereof.

While the insolvency legislation has not taken into consideration the hardships experienced by companies during the COVID-19 pandemic, it will be interesting how the regime develops to reflect the difficult financial situation in The Bahamas.

"Currently, there is no restriction on the filing of winding up petitions under the Companies Act.


Client focused.
World View.

OVERVIEW OF THE RESTRUCTURING LANDSCAPE

The Cayman Islands benefits from a robust and mature restructuring and insolvency regime which has its roots in the English legal system but which has developed specific processes and procedures for handling the unique attributes of Cayman Islands entities that get into financial distress. The restructuring market is supported by well trained and experienced practitioners both in the legal and insolvency practitioner communities and benefits from a stable, effective and efficient court system.

The main legislation that governs insolvency procedures is as follows:

- Companies Act (2021 Revision) (the "Companies Act");
- Companies Winding Up Rules 2018; and
- Insolvency Practitioners' Regulations 2018 ("IPR").

Official liquidation, the main procedure for handling insolvent estates, is a process that is commenced with the filing of a winding up petition in the Grand Court of the Cayman Islands which subsequently oversees the procedure. Post-filing of a petition (or in parallel), an application for provisional liquidation can also be made in circumstances where there is a need to protect assets and/or the status quo, pending the court hearing of the petition. The nominated insolvency practitioners in these cases are typically accountants who, under the IPR, must be resident in the Cayman Islands and possess the necessary qualifications, experience and insurance.

In the absence of having a statutory mechanism similar to the UK administration process, provisional liquidation has become the principal restructuring mechanism for entities in the Cayman Islands. The process provides a moratorium and stable platform within which to propose a scheme of arrangement or similar compromise with creditors. The recent trend in such cases has been for "light touch" provisional liquidation whereby the Directors retain ongoing management of the business allowing the provisional liquidator to focus on a restructuring plan. This procedure has been regularly used with companies listed on the Hong Kong stock exchange, typically with operations in Mainland China, who need to deleverage the balance sheet via such a scheme. However the success of these restructurings has been mixed, with several unable to stave off full liquidation due to more fundamental issues in the underlying businesses. A Restructuring Officer regime is due to shortly come into force in the Cayman Islands to replace provisional liquidation as the principal restructuring mechanism – more on this further in this chapter.

In keeping with other jurisdictions in the Caribbean and elsewhere, insolvency activity has been relatively slow in recent years with a few exceptions, which have largely come about as a result of fraud or financial mismanagement. Practitioners are anticipating an increase in appointments emanating from the global recessionary effects of the COVID pandemic as they impact holding company structures and investment funds. Central government fiscal stimulus packages, suspension of wrongful trading provisions, lack of enforcement activity and the availability of liquidity have all played a part in keeping companies afloat, however, the hugely damaging operational effects of the pandemic in certain sectors (such as travel and hospitality) is likely to filter through the system in the coming years. Also, with the pressures faced by business owners and operators in financially challenging times, the prevalence of fraud and mismanagement increases. This is also likely to lead to an increase in insolvency activity.

Martin Trott
T: +1 (345) 949-7576
D: +1 (345) 814-8729
E: mtrott@RHRestructuring.com
W: www.rhrestructuring.com

Martin specialises in corporate restructuring and insolvency, as an insolvency practitioner in the Cayman Islands and qualified accountant with over 24 years' experience. He is a director of R&H Restructuring (Cayman) Ltd. and R&H Restructuring (BVI) Ltd., and has broad experience in leading complex administrations, liquidations and receiverships across a number of industry sectors. He has significant cross border experience having worked with corporates in the UK, the US, the Caribbean region, Ireland, the Far East, Channel Islands and continental Europe.

Martin is a fellow member of both the Association of Chartered Certified Accountants and the Association of Business Recovery Professionals, and he is also a member of RISA, the Cayman Islands' chapter of INSOL. He is also a member of the American Bankruptcy Institute.

In the absence of having a statutory mechanism similar to the UK administration process, provisional liquidation has become the principal restructuring mechanism for entities in the Cayman Islands.

Recent trends in insolvency and restructuring

As a popular jurisdiction for hedge fund entities and administration (both offshore feeder funds and master funds), the Cayman Islands has seen its fair share of high profile fund collapses in recent years. The liquidation of Platinum Partners Value Arbitrage Fund L.P. ("Platinum") recently entered its fifth year and continues to be focused on recovering value for stakeholders through plaintiff litigation against certain bad actors and the fund's service providers. As is typical for a fund against which a suspected fraud has been perpetrated (in this case, alleged overvaluation of assets and schemes to benefit a selected few insiders, creditors and investors), the liquidation was unfunded and realisations from the few liquid assets in the estate have been tied up in a myriad of competing purportedly secured claims. However, with the benefit of third party funding arranged by the joint official liquidators, litigation has been brought on multiple fronts (some leading to settlements and some ongoing) emanating from the actions in the years leading up to the fund's collapse.

Almost universally these cases involve a considerable amount of cross-border work to recover value from multiple jurisdictions. In Platinum, this has largely involved the US (for example, litigation claims in New York, Delaware and Texas) but also the UK and the Far East. One such asset was an investment in a listed Singapore company, with mining operations in Indonesia and a management team in Australia. Another recent high profile Cayman liquidation, Abraaj Group, involved the Middle East, Asia and Africa. As a result, practitioners utilise their networks of offices or affiliates and, in the pre-COVID era, would travel to countries in which assets and litigation claims are located in order to properly manage the affairs of the liquidation.

Another popular recent trend has been restructuring using a Cayman scheme of arrangement, often as noted previously facilitated by a provisional liquidation. Typically when a group operates in a number of jurisdictions, or has its debt holding company in a territory with limited restructuring options. Cayman is seen as an attractive, neutral alternative with effective laws, courts and practitioners likely to ensure a predictable and fair outcome. The Ocean Rig restructuring in 2017 brought together many recent trends, including a shifting of the group's 'centre of main interest', to successfully restructure its US$3.7 billion debt pile. Another common feature of recent restructuring cases is the use of a litigation trust, which is very common in US Chapter 11 cases. These allow potential litigation claims to be ringfenced from the main business of the group for the benefit of certain group(s) of stakeholders. Another example is the restructuring via a scheme of Schahin II which offered a credible alternative to a Chapter 11 restructuring and also introduced rescue financing to the group. Whilst not going as far as debtor in possession (DIP) financing, the Grand Court is willing to sanction schemes of arrangement with attributes which are clearly designed to be in the best interests of the stakeholders when faced with the less appealing alternative of a liquidation.

When allegations were made against the financial statements of Luckin Coffee in 2020, this Cayman incorporated, Chinese coffee chain entered provisional liquidation in order to explore its restructuring options and stay inbound class action claims in the US. Another recent trend is the bringing of claims under section 238 of the Companies Act which involves the court in determining fair value of shares following a merger or consolidation. These cases are typically brought by disenfranchised shareholders who feel "squeezed out" and not adequately compensated for their investment. They often lead to significant disputes over valuation and a battle between the experts on each side.

Asset realisation and recovery

As one of the leading centres for offshore company structures, investment funds and private wealth trusts, Cayman entities, be it a company, fund, partnership, foundation or trust, often hold assets in jurisdictions across the world. As a result, in an insolvency context, asset realisation and claims enforcement processes are almost always conducted across multiple international borders.

In addition, when a liquidation occurs, cash at bank and other liquid assets tend to be minimal as often owners/directors will have used this liquidity in an attempt to stave off insolvency or, in a fraud context, to enrich themselves. These liquidations will likely therefore be cash "poor" but claims "rich".

An example of this is the liquidation of Madison Asset LLC ("Madison") which commenced in 2018. The company acted as an investment vehicle for (mostly) South American investors to put their money into a quasi-fund which purported to invest in property and other asset classes. The company was part of a larger group which operated throughout South Florida, the Caribbean and Latin America and which has been the subject of allegations of fraud and mismanagement.

> As a popular jurisdiction for hedge fund entities and administration (both offshore feeder funds and master funds), the Cayman Islands has seen its fair share of high profile fund collapses in recent years.

On appointment the official liquidators were immediately presented with a number of challenges. The former director of the company either could not, or would not, hand over the Company's books and records and the liquidators had to contend with the prospect of imminent inbound litigation in the US. One of the often used practices in Cayman liquidations is to seek recognition in foreign jurisdictions in order to protect the assets of the company and assist with recovery efforts via the local applicable restructuring and insolvency legislation. In this case, given the connections to the US and the likelihood of needing to bring and defend US based litigation, the liquidators sought and were granted recognition under Chapter 15, title 11 of the US Code.

Madison's cash position was limited but it has claims with good prospects for success against a number of potential targets. As litigation can be costly and lengthy, it was necessary for the liquidators to seek third party funding in order to progress and continue such claims, where creditors were either unable or unwilling to provide funding. Given the recent expansion of the litigation funding industry, there are now a number of well capitalised, experienced funders who are interested in these opportunities and, in the case of Madison, are willing to fund the liquidator's investigation costs as well as the legal expenses of litigation.

In Platinum, the added complexity from an asset recovery perspective was the investigations being carried out by US authorities and the ensuing indictments and criminal trials of a number of the individuals who are the targets of the liquidator's civil actions. In these situations, cooperation and dialogue with foreign enforcement authorities is key, especially in explaining the role and responsibilities of a Cayman liquidator and oversight of the Grand Court.

Cross border recognition and challenges

A significant advantage of recognition in a foreign jurisdiction is the access to powers that assist in the conduct of the liquidation. In the US, Chapter 15 enables the liquidator to utilise US discovery powers to obtain records from various service providers (under subpoena), whilst diffusing the threat of litigation. In Madison, the company's books and records were unable to be recovered and so had to be recreated from records obtained via subpoenas from the various banks and service providers to the company.

An alternative to Chapter 15 is section 1782, title 28 of the US Code which also provide powers to a foreign representative to get discovery from a party in order to obtain records and information. However, this is very targeted (each application has to name the party and the information sought) whereas Chapter 15 recognition avoids the need to revert to court each time a party is identified from which discovery is sought.

In aid of foreign proceedings, courts in other jurisdictions will also recognise liquidators such as in the UK by way of an application under section 426 of the UK Insolvency Act. In particular, provisional liquidators are often granted recognition by the Hong Kong court (by way of letter of request from the Grand Court) where the company is listed on the Hong Kong stock exchange thereby enabling an environment where a restructuring has the best prospects of being achieved.

Upcoming developments

Whilst "light touch" provisional liquidation is used for restructuring purposes, it was not specifically designed for that purpose. As a result, legislation has recently been drafted, with accompanying rules, to introduce a restructuring officer regime into the Companies Act. Some key advantages, should this legislation come into effect in its current form, are that there would be no need for a winding up petition to be filed, an immediate moratorium would be in place on filing the application (with extraterritorial effect) and directors would be able to initiate the process without the consent of shareholders.

This would clearly introduce a more debtor friendly provision to the practitioners "toolkit" and bring Cayman into line with other jurisdictions by having a process firmly aimed at restructuring a company's debts. However, Cayman would still be largely a creditor friendly jurisdiction; for example, secured creditors rights would continue to enjoy priority status and there is no suggestion yet of new funding being able to rank ahead of all other debt.

Another development is the Private Funding of Legal Services Act which is subject to a commencement order to bring it into force. This seeks to abolish the doctrine of maintenance and champerty (which has already been abolished in other jurisdictions such as England & Wales) which, up to now, has made litigation funding agreements both challenging to negotiate with funders and challenging to get sanction for from the Grand Court. If introduced, this is likely to make the important process of funding claims in liquidations more straightforward to obtain and utilise.

Additionally it would enable law firms in Cayman to be able to offer/agree conditional fees (discounted fees with uplift on success) or contingency fees (fees only on success as a percentage of the recoveries). This would have the effect of matching the risk of an assignment, from a fee recovery perspective, to the potential reward. It may also lead to "hybrid" funding agreements involving both a law firm and a third party funder thereby covering other costs in bringing claims such as litigation expenses (court fees, e-discovery costs, expert witness costs) and liquidator's fees.

"Given the recent expansion of the litigation funding industry, there are now a number of well capitalised, experienced funders who are interested in these opportunities and, in the case of Madison, are willing to fund the liquidator's investigation costs as well as the legal expenses of litigation.

INTERNATIONAL INSOLVENCY & RESTRUCTURING REVIEW --CHINA 2020

Xiuchao Yin
Senior partner
Beijing Dentons Law Offices, LLP

W: www.dentons.com/en/xiuchao-yin
E: xiuchao.yin@dentons.cn
T: (+86) 137 0116 3012

Lawyer Yin has 21 years of professional experience in the area of bankruptcy reorganisation and liquidation. He attaches great importance to protecting the legal rights of creditors, balancing the interests of all parties in the reorganisation process, and reducing bankruptcy costs in the reorganisation process.

Lawyer Yin's professionalism has been recognised by a number of relevant professional institutions. From 2018 to 2020, for three consecutive years, Lawyer Yin was invited to provide consulting and research papers on the bankruptcy in China's business environment for the business environment investigation officials of the world bank, and was invited by GLG, a world-renowned industry expert think tank, as a consulting expert, consulted and answered questions on China's bankruptcy and debt restructuring for leading financial investment institutions and investment management institutions repeatedly. Lawyer Yin has written many professional legal articles for magazines such as 'Lexis Nexis', 'Thomson Reuters', 'Getting the deal through' and so on. Lawyer Yin was invited to write the article 'Getting the Deal Through: Restructuring & Insolvency-China' for the well-known magazine Getting the deal through in 2020. Lawyer Yin accepted the invitation to write the chapter of China's bankruptcy law for International Insolvency &Restructuring Review 2021/2022 on November 13, 2020. In 2020, Lawyer Yin was selected by the internationally renowned legal media as the China bankruptcy Restructuring Lawyer of who's who legal 2020.

At the same time, Lawyer Yin participates in social activities actively. He is serving as a consultant of the expert advisory committee of the Supreme People's Procuratorate, the leader of RIB(Restructuring, lnsolvency and bankruptcy) Groups of Beijing Dentons Law Offices, LLP in China region (2015-2018), the director of the Business Law Research Association of Chinese Law Society, the Secretary-General of the Bankruptcy Restructuring Committee of the China Law Association, and the director of the Bankruptcy Committee of the Beijing Law Association. He has been invited to give lectures on bankruptcy law practice in various public welfare classes for many times during 2020, including:

1. The business environment lecture series of the Supreme People's Court, whose audiences are all Chinese organisations and institutions related to optimising the business environment. Lawyer Yin was the first lawyer who had been invited to share and exchange the working experience of the bankruptcy administrator in such a lecture.

2. Lawyer Yin accepted the invitation of the first 'Lawyer's Public Welfare Practice Lecture', which is co-sponsored by East China University of Political Science and Law, China Civil and Commercial Law Network, and shared the practical experience of bankruptcy law in the lecture.

3. Lawyer Yin accepted the invitation of the Chaoyang District Lawyers Association of Beijing and gave lectures on bankruptcy legal business in the "Legal Broadcasting Live Room" in the mode of webcast.

4. Lawyer Yin accepted the invitation of Dianjing net, a follow-up education and training institution of the National Lawyers Association, to provide pre-restructuring legal lectures to lawyers throughout the country via the Internet.

5. Lawyer Yin was invited by the Beijing Business Service Federation to provide lectures on bankruptcy law to Beijing business service enterprises.

Zhiguo Yang
Partner
Beijing Dentons Law Offices, LLP

E: zhiguo.yang@dentons.cn
T: (+86) 186 1842 650

Mr. Yang Joined Dentons Beijing in 2007, and now is a partner of Dentons Beijing.
Mr. Yang has over 10 years of experience in debt restructuring, insolvency and settlement operations, corporate dissolution and liquidation, mergers and acquisitions, joint ventures, corporate restructuring. He has served as the leading counsel for a number of transactions and was instrumental in their structuring, negotiations and implementation. His experience covers a wide variety of industries, including manufacturing, machinery, solar energy, real estate.

For the past few years, his business focused on bankruptcy reorganisation, he deeply participated in the bankruptcy reorganisation case of Harbin Bearing Group and ZAX Company as a important member of bankruptcy administrator. Additionally, in some serious and complex case, he also claimed legitimate rights and interests on behalf of creditors.

Mr. Yang Zhiguo received his JM (juris Master) from Tsinghua University in 2007. He was qualified as a Chinese Lawyer in 2009.

The Covid-19 ravaged the world in 2020. Some Chinese enterprises, under the influence of multiple factors such as supply-side reform, macroeconomic structural adjustment and epidemic situation, were on the edge of existence. The Chinese government has made all-out efforts to prevent and control the disease, and put forward "six stabilities" requirements (to ensure stability in employment, financial operations, foreign trade, foreign investment, domestic investment, and expectations) and "six priorities" requirements (to ensure security in job, basic living needs, operations of market entities, food and energy security, stable industrial and supply chains, and the normal functioning of primary-level governments), the local governments have helped enterprises to solve problems by vigorously promoting bankruptcy and optimising the business environment. According to the work report of the Supreme People's Court, Chinese courts concluded 10,132 bankruptcy cases involving 1.2 trillion yuan of claims in 2020. There were 728 restructuring cases among them, and the assets amounted 470.8 billion were activated and mobilised. The Beijing Bankruptcy Court received 1,476 new bankruptcy cases and concluded 1,105. The rate of receiving cases increased by 7.11 times, and the rate of settling cases increased by 5.42 times.

Part I The Government and the Courts Jointly Issued Policy Documents

The Supreme People's Court issued some measures timely, where an enterprise is unable to repay debts due because of the impact of the epidemic situation or epidemic prevention and control measures, and its creditors have submitted a bankruptcy application, the people's court shall actively guide the debtor and the creditor to negotiate and eliminate the reasons for the bankruptcy application through adoption of payment by installments, extension of debt performance period, change in contract price, etc., or guide the debtor to resolve the debt crisis through out-of-court mediation, out-of-court restructuring, pre-reorganisation, etc., so as to achieve rescue of the enterprise as soon as possible.

The Supreme People's Court promulgated the Opinions on Promoting the Lawful and Efficient Hearing of Bankruptcy Cases on April 15, 2020, it focuses on the optimising procedures for case announcement and acceptance, improving the methods of debtor's property takeover and investigation, improving upon the efficiency of convening and voting on creditors' meetings, establishing a mechanism for speedy trial of simple cases and intensifying enforcement measures and cracking down on debt evasion.

Where, in the bankruptcy reorganisation proceedings, a draft reorganisation plan cannot be made on time due to the failure to recruit investors, conduct due diligence, consultation and negotiation and other reasons as affected by the epidemic situation or epidemic prevention and control measures, the people's court may, at the request of the debtor or administrator, reasonably determine the period that shall not be included in the period specified in Article 79 of the Enterprise Bankruptcy Law based on the actual degree of impact of the epidemic situation or epidemic prevention and control measures on the reorganisation work, but generally such period shall not exceed six months. Where the reorganisation plan or reconciliation agreement has entered the enforcement stage, but it is difficult to be enforced by the debtor due to the impact of the epidemic situation or the epidemic prevention and control measures, the people's court shall actively guide the parties concerned to make changes through full consultation.

The National Development and Reform Commission and the Supreme People's Court jointly issued the Reform Plan for Accelerating the Improvement of the Exit System of Market Entities in 2019 and the Opinions on Providing Judicial Services and Supports to Accelerate Improvement of the Socialist Market Economy System in the New Era on July 22, 2020. In order to fully promote and ensure the administrators to perform their duties according to law, improve bankruptcy efficiency, and give full play to institutional functions, the National Development and Reform Commission and the Supreme People's Court jointly issued the Opinions on Promoting and Ensuring Administrators to Perform Their Duties in the Bankruptcy Procedure and Further Improving the Business Environment in March 2021.

The Supreme People's Court also specially issued relevant documents, emphasising the rescue mechanisms of bankruptcy system, simplifying procedures for filing and hearing bankruptcy cases, initiating a series of facilitation measures for creditors to report their claims, promoting online convening of creditors' meetings and extending the time limit for making restructuring plans, etc., which reflects the service functions and protective functions of bankruptcy judicial trial. These policies and measures not only focus on helping enterprises resume work and production, but also strengthen the disposal of bankrupt property, reduce the procedures for asset appraisal and auction, fully protect the legitimate rights and interests of creditors, innovate and explore systems for anticipatory reorganisation and out-of-court reorganisation, advocate the application of the bankruptcy reconciliation system, and improve the efficiency of enterprise rescue.

> Local governments have helped enterprises to solve problems by vigorously promoting bankruptcy and optimising the business environment.

Judges and administrators of bankruptcy trials around the country choose to use modern scientific and technological means to assist the handling of bankruptcy cases, promote the informationisation of bankruptcy trials, draft practical guidelines applied during the epidemic, and handle bankruptcy cases flexibly. For example, after the outbreak of the epidemic, for some bankruptcy cases related to epidemic prevention and control, the bankruptcy court provided emergency assistance to allow the enterprises to produce epidemic prevention materials and recalled the employee who are in liquidation proceedings, which not only helped the bankrupt enterprises to resume business, but also expanded the production of epidemic prevention and control equipment.

In 2020, Beijing, Shanghai, Chongqing and Guangdong respectively issued the Regulations on Optimising the Business Environment, which focused on the reform of streamlining administration, delegating powers, improving regulation and optimising services, especially it made a series of clear and specific provisions on supporting and guaranteeing bankruptcy administrators, and improved the efficiency of handling bankruptcy.

In 2020, 10 papers related to bankruptcy law were included in China Legal Science Citation Index (CLSCI).

Part II Changes in the Judicial System

On May 28, 2020, the Civil Code of the People's Republic of China was promulgated and came into force on January 1, 2021. The new contract rules, property right rules and guarantee rules stated in the Civil Code have a direct impact on the current bankruptcy law. In particular, the provisions on guarantee contract in the Civil Code have influenced the application of the Bankruptcy Law and the creditor's right of revocation against the debtor's free act in the Civil Code has an impact on the right of revocation in bankruptcy.

On August 26, 2020, the Standing Committee of the Shenzhen Municipal People's Congress completed the formulation of Personal Bankruptcy Ordinance of Shenzhen Special Economic Zone, which already came into force on March 1, 2021. The cities of Wenzhou and Taizhou in east China's Zhejiang Province are also exploring the creation of a personal bankruptcy system, it reflects that China's social and economic development and the accumulation of private wealth of its citizens have reached a high level.

The Supreme People's Court has formulated a judicial interpretation on the guarantee system in the Civil Code, issued a written reply on whether state-owned land-use rights allocated by bankrupt enterprises should be included as bankruptcy property, and detailed guidance on some choke points encountered in bankruptcy cases. The Beijing Bankruptcy Court also formulated the Guidelines for Bankruptcy Case Managers (Trial) in 2020.

In 2020, China set up five bankruptcy courts, namely Jinan Bankruptcy Court, Qingdao Bankruptcy Court, Nanjing Bankruptcy Court, Xiamen Bankruptcy Court and Suzhou Bankruptcy Court, to concentrate on the handling of bankruptcy cases within the jurisdiction of the region and enhance the professional trial capacity. Two provincial bankruptcy administrators' associations and nearly 50 prefecture-level bankruptcy administrators' associations have been established. At present, there are more than 120 bankruptcy administrators' associations in China. During the epidemic prevention and control period, the Supreme People's Court launched a seminar on the business environment, in which two experts, two lawyers (the author is one of the lawyers), one judge and one government official gave some lectures in order to promote and exchange experience in bankruptcy.

> In 2020, Beijing, Shanghai, Chongqing and Guangdong respectively issued the Regulations on Optimising the Business Environment.

In order to reduce the cost of handling bankruptcy, local courts use Internet technology to auction and dispose bankruptcy properties through online platform companies such as Alibaba and Jingdong, release and communicate information through online conference systems such as DingTalk and WeChat, and even simplify evaluation procedures.

Part III Bankruptcy Trial Practice

In 2020, the judicial service and guarantee functions of bankruptcy trials were given full play. Baoshang Bank went into liquidation, becoming the first financial institution to go into liquidation in accordance with the Enterprise Bankruptcy Law. The merger reorganisation of Founder Group with its other four Group Companies has become the largest bankruptcy case (over 300 billion yuan) heard by Beijing Bankruptcy Court. The ongoing HNA Group bankruptcy cases and Yurun Group bankruptcy cases are hundreds of billions of super large group bankruptcy cases. A total of 408 real estate companies issued bankruptcy notices in 2020 according to statistics from China House Company (www. Fangchan.com). According to the Metallurgical Association, 30 steel companies across the country have entered bankruptcy proceedings in 2020. Additionally, some super large real estate group companies are restructuring debt. work-out, as a system before formally entering the bankruptcy procedure, reduces the risk of bankruptcy, improves the success rate of reorganisation, and becomes an effective bankruptcy system gradually applied by many bankruptcy courts.

In 2020, a total of 18 listed companies solved their debt crisis through the application of Bankruptcy Law.

In another notable case, a number of insurance companies and trust companies have been dragged into administrative receiverships. For example, Hua Xia Life Insurance and Xinhua Trust were taken over by China Banking and Insurance Regulatory Commission, and New Era Securities, Guosheng Securities and Futures were taken over by China Securities Regulatory Commission.

> A number of insurance companies and trust companies have been dragged into administrative receiverships.

Section IV Future Development

Both legislation and practice of bankruptcy trial in China are developing from marketisation and legalisation to internationalisation. Although only Article 5 of the Enterprise Bankruptcy Law covers cross-border bankruptcy, the number of practical cases related to the cross-border bankruptcy is increasing. In 2014, the Bankruptcy Court of New Jersey in the United States recognised the bankruptcy proceedings of Zhejiang Jianshan Optoelectronics in China. In 2019, the U.S. Court for the Southern District of New York recognised the bankruptcy proceedings of Beijing Rova Technologies and allowed the Chinese bankruptcy administrator to dispose of assets in the United States. In 2020, the High Court of Hong Kong recognised the bankruptcy proceedings of Shanghai Huaxin heard by the Third Middle Court of Shanghai and recognised the validity of the bankruptcy case of Nian Fu Company heard by the Shenzhen Intermediate People's Court. The High Court of Singapore acknowledged the insolvency proceedings of the Sainty Marine case heard by the Nanjing Intermediate Court. On May 14, 2021, the Supreme People's Court and the High Court of the Hong Kong Special Administrative Region signed the Minutes of the Talks on Mutual Recognition and Assistance of the Courts of the Mainland and the Hong Kong Special Administrative Region in Bankruptcy Procedure, marking a breakthrough in cross-border bankruptcy cooperation.

The National People's Congress (NPC) has released a legislative plan to amend the Enterprise Bankruptcy Law in 2021 and is soliciting public opinions. It can be predicted that China's bankruptcy law, both in legislation and in practice, will have greater development and changes in 2021. The Chinese government will be more adept at using the bankruptcy law to safeguard and promote economic development, protect creditors' interests and increase investor confidence.

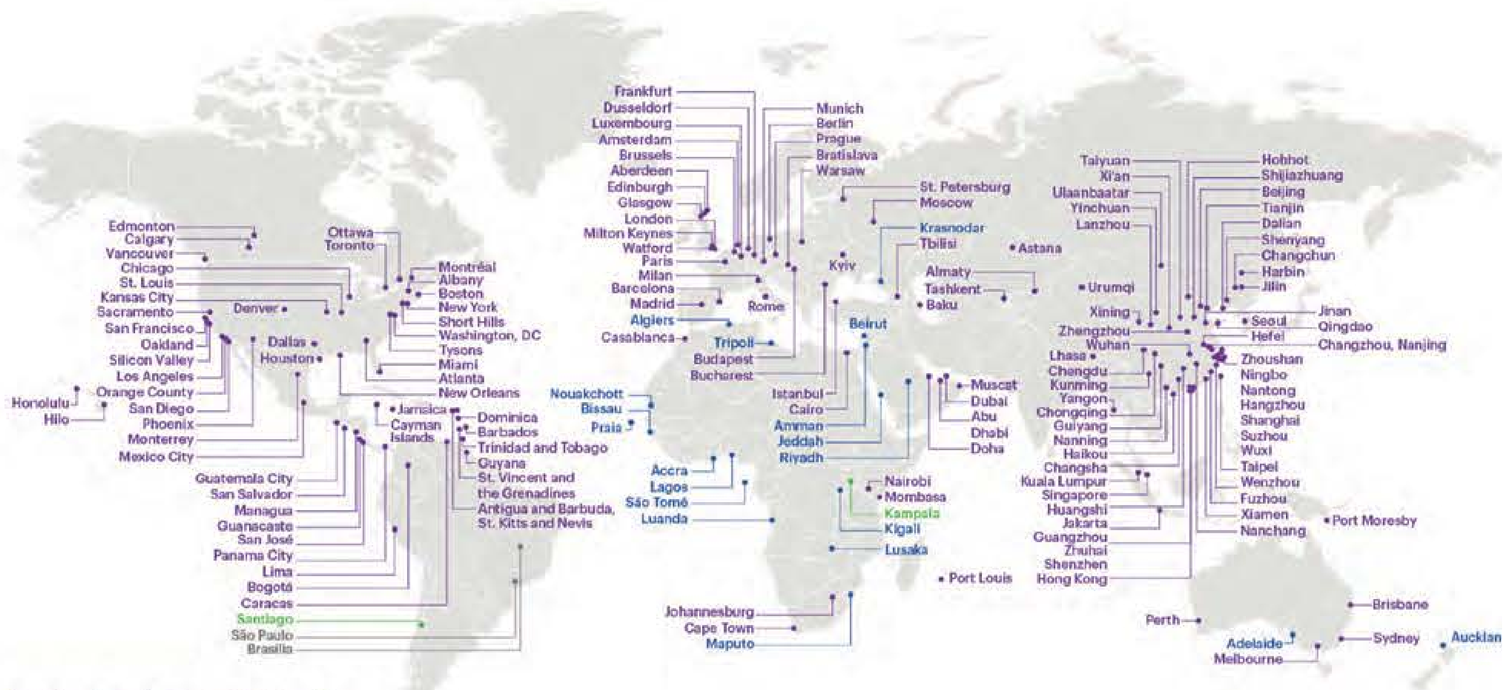
GLOBAL REACH, LOCAL INSIGHT

Dentons' China region consists of 45 offices, spanning all of the nation's provinces and autonomous regions. It was formed through the 2015 combination of global firm Dentons and Chinese firm 大成. Partly as a result of that combination, Dentons is now the largest law firm in the world.

Founded in 1992, 大成 was one of the first partnership law firms in China and is now one of the largest. 大成 began implementing its first five-year plan in 2004, and in 2007 the firm launched its strategy of building a global legal services network. Through the rapid expansion that has resulted, 大成 lawyers gained access to global resources, referrals, knowledge and experience—enhancing delivery of cost-effective, agile and efficient service to clients.

From 2005 to 2010, 大成 was named an "Outstanding Law Firm in China" for six consecutive years, and topped Asian Legal Business' annual rankings of "ALB China Top 20 Largest Law Firms" and "ALB Asia Top 50 Largest Law Firms" for years.

With more than 10,000 lawyers serving more than 70 countries,Dentons offers clients the benefit of quality experience in and of the communities in which they want to do business or resolve a dispute—from Canada and the United States, across Europe, the United Kingdom, the Middle East and Africa, Australia, Latin America and the Caribbean and throughout the Asia Pacific region. Through broad and in-depth cooperation between the most influential law firms from China and the West, we are innovating the world's legal services sector and marking a milestone in the history of the global legal profession.



Locations in purple represent Dentons offices.
Locations in blue represent associate firms, offices and special alliances.
Locations in green represent proposed combinations that have not yet been formalized.
Locations in grey represent Brazil Strategic Alliance.

Aberdeen
Abu Dhabi
Accra
Adelaide
Albany
Algiers
Almaty
Amman
Amsterdam
Ashgabat
Astana
Atlanta
Baku
Barbados
Barcelona
Beijing
Beirut
Berlin
Bissau
Bogotá
Boston
Brasília
Bratislava
Brisbane
Brussels
Bucharest
Budapest

Cairo
Calgary
Cape Town
Casablanca
Changchun
Changsha
Changzhou
Chengdu
Chicago
Chongqing
Dalian
Dallas
Denver
Doha
Dubai
Edinburgh
Edmonton
Frankfurt
Fuzhou
Glasgow
Guanacaste
Guangzhou
Guatemala City
Guiyang
Haikou
Hangzhou
Harbin

Hefei
Hilo
Hohhot
Hong Kong
Honolulu
Houston
Huangshi
Istanbul
Jeddah
Jilin
Jinan
Johannesburg
Kampala
Kansas City
Kigali
Krasnodar
Kunming
Kyiv
Lagos
Lanzhou
Lhasa
Lima
London
Los Angeles
Luanda
Lusaka
Luxembourg

Madrid
Maputo
Melbourne
Mexico City
Miami
Milan
Milton Keynes
Minsk
Monterrey
Montréal
Moscow
Munich
Muscat
Nairobi
Nanchang
Nanjing
Nanning
Nantong
New Orleans
New York
Ningbo
Nouakchott
Orange County
Ottawa
Panama City
Paris
Perth

Phoenix
Port Louis
Port Moresby
Prague
Praia
Qingdao
Riyadh
Rome
Sacramento
San Diego
San Francisco
Oakland
San José
San Salvador
São Paulo
São Tomé
Seoul
Shanghai
Shenyang
Shenzhen
Shijiazhuang
Short Hills
Silicon Valley
Singapore
St. Louis
St. Petersburg
Suzhou

Sydney
Taipei
Taiyuan
Tashkent
Tbilisi
Tehran
Tianjin
Toronto
Tripoli
Tysons
Ulaanbaatar
Urumqi
Vancouver
Warsaw
Washington, DC
Watford
Wenzhou
Wuhan
Wuxi
Xiamen
Xi'an
Xining
Yangon
Yinchuan
Zhengzhou
Zhoushan
Zhuhai

KEY DEVELOPMENTS, THE LATEST TRENDS AND SOLUTIONS IN THE SWISS AND GERMAN RESTRUCTURING MARKET

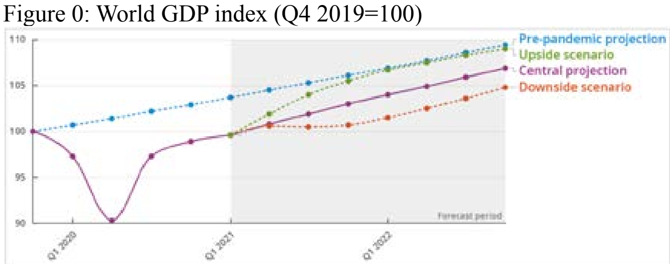
This chapter sets out recent developments in the German and Swiss markets for insolvency and restructuring, with relevant statistics and survey results. It also looks at the refinancing and M&A environment, with particular emphasis on the distressed segment. It then describes the different time frames for recovery from COVID-19 focusing on how business remain undergoing fundamental restructuring can come out stronger than before. Management teams face the challenge of reviewing their corporate strategy and this article sets a strategic option review framework for decision making. It also addresses the issue of how best to prepare an entity for sale where a restructuring is unlikely to lead to a desired outcome.

Introduction

Orchestrating the recovery from the COVID-19 pandemic has required unprecedented coordination and collaboration across organisations, markets, and the economy at large.

The shape of the recovery will depend on the speed of vaccination programmes the threat from emerging variants of the virus, and the pace of recovery is expected differ between advanced and emerging market economies. According to the OECD Economic Outlook released in March 2021, global GDP growth is projected to be 5.6 per cent in 2021 and world output is expected to reach pre-pandemic levels by mid-2021 (see figure 1)[1,2]. According to an economic outlook developed by Swiss Life[3], at the end of the first quarter of 2021, business sentiment indicators are showing a strong increase in the Eurozone, with GDP expected to recover by 4.4 per cent in 2021 and 3.0 per cent in 2022. The forecast for Germany was for 3.5 per cent GDP growth in 2021 and 3.0 per cent in 2022, and for Switzerland the forecast growth was 3.6 per cent in 2021 and 2.2 per cent in 2022 - driven by the effectiveness of the vaccination campaign over the coming quarters in particular.

Figure 0: World GDP index (Q4 2019=100)



Source: OECD Economic Outlook, Interim Report March 2021

Jan-Dominik Remmen
Deloitte - Switzerland
Partner & Head of Restructuring Services

Jan is a Financial Advisory Partner based in Zurich and is leading the Swiss Restructuring Services practice. His specialist areas include exiting underperforming businesses and winding down and liquidating legal entities. His record of accomplishment includes advising shareholders in the context of legal entity rationalisation / corporate simplification programmes and setting up new legal entities, including Societas Europaea (SE).

Jan is the lead Swiss partner advising global banks in winding down or setting up private banking operations in Switzerland. He has acted as the liquidator in a number of proceedings in Switzerland. He has led major corporate transformations and transactions for multinational corporations and has advised management teams in the context of asset efficiency programmes.

Jan holds an MSc from London Business School, an MSc in Industrial Engineering from the Technical University of Berlin and a Bachelor's degree in Business Administration from Georgetown University.

Dr. Thomas Sittel
Deloitte - Germany
Partner Restructuring Services

Advises clients on key areas of their entrepreneurial activities, such as M&A, financing and transformation: with 23+ years' experience, he has developed a comprehensive expertise in structuring complex, mostly cross-border M&A transactions. This includes advising on crisis, insolvency, succession and carve out situations.

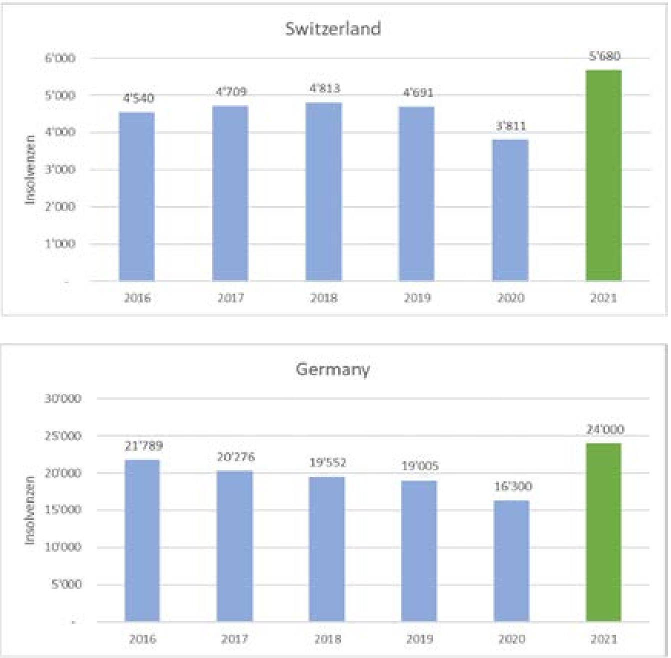
Thomas has extensive experience in transformation and as well as out projects. His client network includes multinational and medium-sized companies, and the restructuring and workout units of banks, as well as institutional investors (e.g. private equity, family offices).

Thomas is a certified bank clerk and accredited lawyer. He studied company and tax law at the Universities of Freiburg and Munich and earned his PhD at the Dresden University of Technology.

[1] OECD Economic Outlook March 2021
[2] https://www.imf.org/en/Publications/GFSR/Issues/2021/04/06/global-financial-stability-report-april-2021
[3] https://www.swisslife-am.com/content/dam/slam/documents_publications/Perspectives-Financial-Markets/fm_april_2021/0421_Perspectives_financial%20markets_DE.pdf

The pandemic has not yet led to an increase in the number of insolvencies in Germany or Switzerland. The number of insolvencies in Germany has actually fallen by eight per cent between 2019 and 2020 in Germany and by 19 per cent in Switzerland. It seems that measures to deal with COVD kept insolvencies at bay in 2020. Measures that have helped businesses of all sizes to avoid financial distress include financial support from government; short-time working arrangements; the suspension of requirements to file for insolvency; financial restructuring; cost reduction and working capital improvement programmes; and mergers and acquisitions.

Figure 1. Number of insolvencies in Switzerland and Germany FY2016-FY2021



Source: Dun & Bradstreet, Creditreform and the Institut der Deutschen Wirtschaft (IWD)

Euler Hermes expects the number of insolvencies in Switzerland to increase to about 5,680 in 2021, as government measures have expired or are due to expire in the second half of the year, and a number of industry sectors are facing structural changes. A return to historical levels of insolvencies is expected in 2022. The number of insolvencies each year has fallen by more than 50 per cent in Germany since 2009 to the lowest levels in history, but it is expected to increase by almost 50 per cent to about 24,000 in 2021.

The most affected are businesses operating in tourism and hospitality, retail and consumer goods, and manufacturing and chemicals. The reasons why they are affected most by the current situation are mostly financial in nature.

Irrespective of the sector that their company is operating in, the Swiss CFO survey[4] identified some key challenges that organisations should be aware of and prepare for, particularly the risk of default on debt payments.

Figure 2. Business sector and impact analysis, October 2020

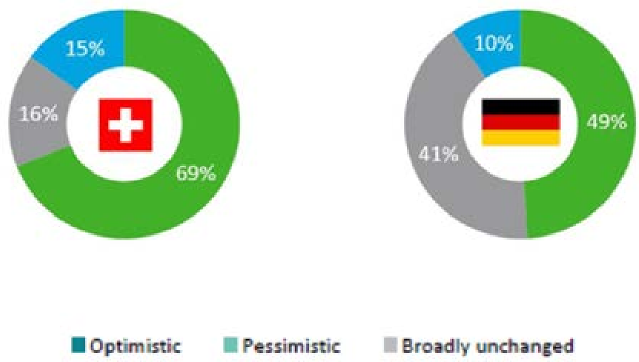
	Total	Services	Tourism & Hospitality	Retail & Consumer goods Industry	Financial Services	Pharma/Life Sciences / Medical Technology / Health	Manufacturing & Chemical industry	Information & Communication technology	Construction industry
Short-time work / wage adjustments / pension reductions / dismissals	49%	46%	95%	76%	18%	36%	73%	33%	51%
Stop or delay of planned investments	41%	37%	64%	56%	24%	40%	55%	43%	47%
Waive profit distribution / dividend payments	27%	35%	32%	22%	14%	17%	36%	33%	40%
Claim COVID-19 credits	20%	25%	45%	20%	10%	17%	24%	33%	15%
Postpone capital repayments / amortisations / interest payments	13%	12%	23%	10%	8%	12%	13%	10%	15%
Additional debt financing (excluding COVID-19 credits)	12%	5%	23%	22%	11%	17%	15%	5%	11%
Additional self-financing	11%	20%	9%	12%	5%	10%	15%	10%	6%
Precautionary utilisation of existing credit limits	11%	6%	14%	20%	4%	14%	20%	5%	11%
Wind-down of underperforming divisions or locations	7%	5%	27%	7%	6%	7%	7%	5%	4%

Well below average · Average · Above average · Well above average · Companies particularly affected

Source: Deloitte, Navigating Volatility and Distress, Sector Overview including COVID-19 impact

Deloitte's recent European CFO study, H1 2021, identifies some of the key challenges for 2021 and beyond, based on ratings by CFOs rating of their company's financial outlook compared with three months previously.

Figure 3. CFO rating of their company's financial outlook over the next 12 months as per end of Q1 21, compared with three months previously

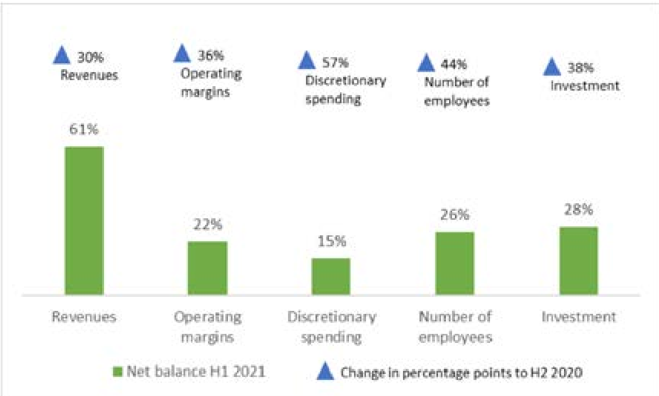


Source: The Deloitte CFO Survey, H1 2021 | Results of the Swiss and European CFO surveys

This study provides evidence of a mixture of both improvement and modest, patchy growth in with regard to CFOs' expectations about specific corporate performance indicators. The most striking example of greater optimism is in the revenue expectations of CFOs in Switzerland. However, the base line for future growth is relatively low, as companies still must make up for revenue losses during the pandemic. Expectations regarding operating margins are more modest, with most CFOs remaining pessimistic about a recovery in margins.

The most pessimistic indicator in the survey was for expectations regarding employment: most CFOs continue to rate these as negative. There is evidence of an improvement in performance indicators in most of the European countries surveyed. However, in many cases, this was insufficient to re-establish positive expectations. Some countries, including Germany, are showing a substantial recovery, with expectations for revenues, operating margins and investment all positive, although expectations for employee numbers remain negative.

Figure 4. CFO's expectations about their company's key performance indicators (positive or negative) over the next 12 months

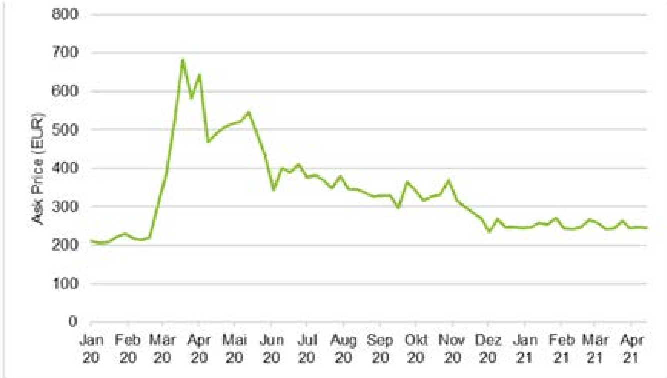


Source: The Deloitte CFO Survey, H1 2021 | Results of the Swiss and European CFO surveys

Refinancing Environment

The refinancing environment has changed significantly since the initial peak of the pandemic in March 2020, both in terms of debt availability and the cost of debt. The iTraxx Crossover Index, comprising the 75 most liquid sub-investment grade entities, has eased from around 680 bps during the peak to less than 250 bps in April 2021 (Figure 5).

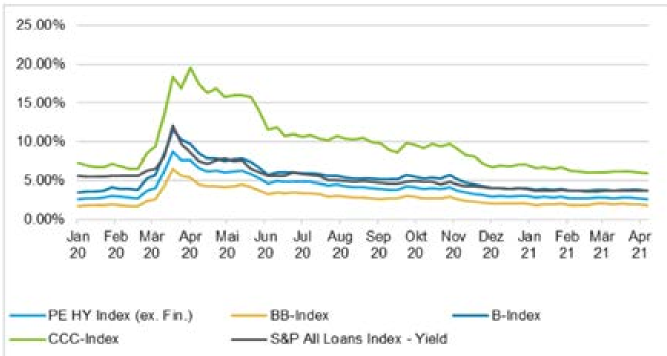
Figure 5. iTraxx Europe Crossover Index



Source: Bloomberg

European institutional loan issuance declined in 2020, as the exceptionally strong start to the year in January and February came to a halt with the outbreak of the COVID-19 pandemic in March 2020. Amid this market volatility, support and stimulus from central banks calmed the debt markets and restored investor confidence. An impressive increase in loan and bond volumes characterised the start of 2021 driven by restored market confidence and a fall in the cost of debt, especially for non-investment grade debt and alternative financing. The falling average cost of debt for non-investment grade loans is exemplified by the Barclays Pan-European High Yield Index in Figure 6, where the B and CCC indices fell from 12 per cent in March 2020 to 4.3 per cent and 7 per cent respectively at the end of the year.

Figure 6. Barclays Pan-European High Yield Index

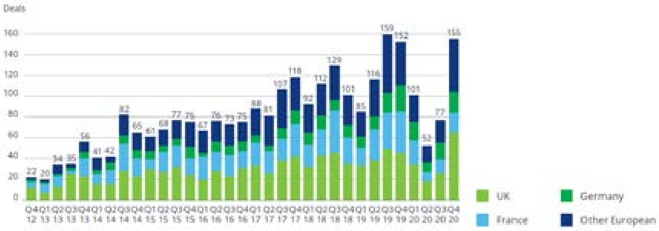


Source: Bloomberg

[4] Source: 2020 Deloitte Swiss CFO Survey

The Deloitte Alternative Lender Deal Tracker (see Figure 7) shows the surge in alternative financing in Q4 2020.

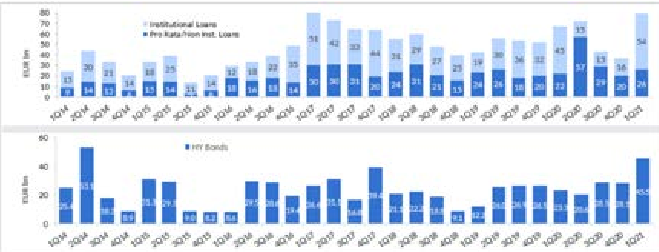
Figure 7. Alternative Lender Deal Tracker



Source: Deloitte Alternative Lender Deal Tracker Spring 2021

Borrower-friendly conditions also prevailed in the leveraged loan and high yield bond markets during Q1 2021, as companies had ready access to the market to refinance existing debt or raise new funding (Figure 8). Leveraged loan issuance was extremely active, reaching EUR 79.6bn in Q1 2021, well above the comparative total of EUR 67.7bn in the previous year, with the institutional loan segment alone amounting to EUR 53.7bn – the highest quarter on record. European borrowers tapped the high yield bond market for EUR 45.5bn, the second highest quarterly level on record. From a credit quality perspective, market conditions have reflected a ‘risk-on’ environment at the beginning of FY 2021, with more than two-thirds of institutional loan volumes rated B and below.[5]

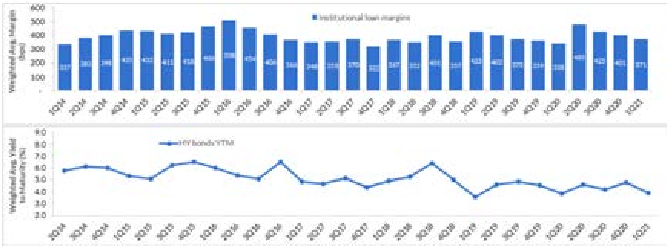
Figure 8. European leveraged loan and high yield bond markets volume FY2014-Q1 FY 2021



Source: Debtwire

In tandem with the surge in loan repricing volume, the supply-demand imbalance led to tighter pricing across the board in 1Q21. Tighter pricing, not surprisingly, was also a feature of the high yield bond primary market, with the 1Q21 average yield to maturity at 3.66% for European currency-denominated notes (Figure 9).

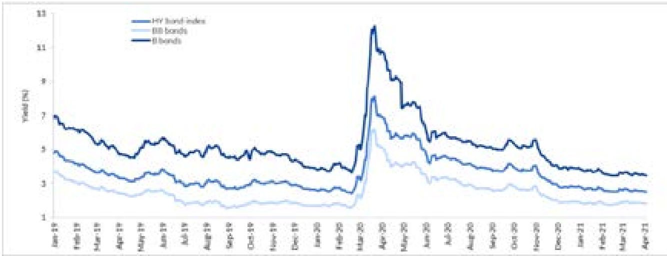
Figure 9. Institutional loan margins and HY bonds YTM FY2014-Q1 2021



Source: Debtwire

The secondary markets have also been supportive of issuance in the primary markets. Given the appetite for credit, secondary loan prices have recovered fully from the pandemic-driven slump in 2020. The pandemic-hit retailing and entertainment and leisure sectors led the market lower in March, although both sectors were up overall in Q1 2021 (Figure 10)

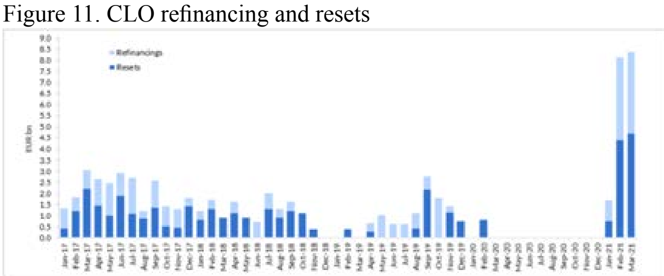
Figure 10. ICE BofA Euro High Yield Bond Index



Source: Debtwire

From a collateralised loan obligation (CLO) perspective, lower pricing and tightening in liability spreads facilitated a surge in refinancings (EUR 8.3bn) and resets (EUR 9.8bn) in Q1 2021. This was in sharp contrast to 2020 when there were no CLO refinancings, and resets amounted to just EUR 790m over the course of the full year (Figure 11).

Figure 11. CLO refinancing and resets



Source: Creditflux

[5] Debtwire: March 2021 European Leveraged Insights Report

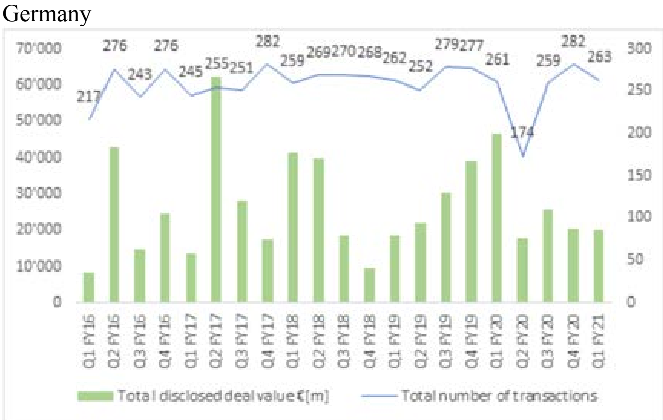
M&A Environment

After increasing for years, the M&A market showed already some weakness regarding the economic development in Q3 2019, much earlier than COVID-19. Despite historically high levels of 'dry powder' of strategic as well as financial investors, a change in sentiment was already noticeable.

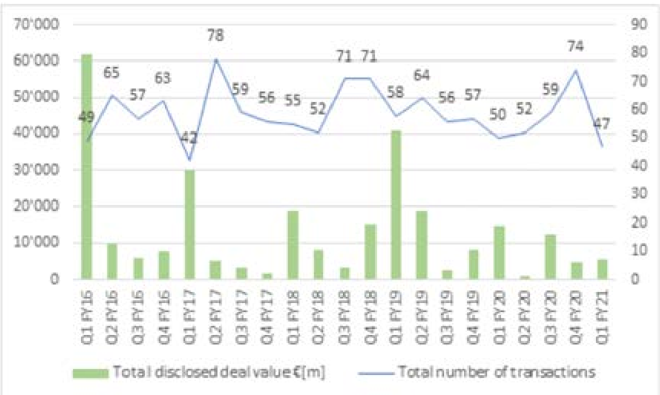
With the COVID-19 pandemic outbreak in the Western world followed a dramatic decline of more than 50% in Q2 2020 compared to previous year's quarter, resembling the lowest level of M&A activity since 2009. Since then the M&A market has rebounded in Q3 and Q4 2020 and the positive trend has continued in the first quarter of 2021, recording the highest quarterly figures since 2007.

Figure 12. Number and value of M&A transactions in Germany and Switzerland through Q1 2021

Germany



Switzerland



Source: Mergermarket, Merrill Corporation
Switzerland

For many years strategic investors carried out about two-thirds of all M&A transactions in Europe, and the remaining one-third was executed by financial investors. This ratio shifted dramatically in 2020. The share of private equity deals rose from 32% in Q1 2018 to a historical high of 42 per cent. Possible reasons for this change are a disproportionate increase in 'dry power' by private equity investors, and more conservative behaviour by strategic investors, preserving liquidity and showing restraint in adding further to their debt levels.

With regard to transactions out of insolvency, a Deloitte analysis shows that the number of transactions in Europe fell from 279 transactions in 2019 to only 231 in 2020 – in line with the decreasing number of insolvencies during that time period.

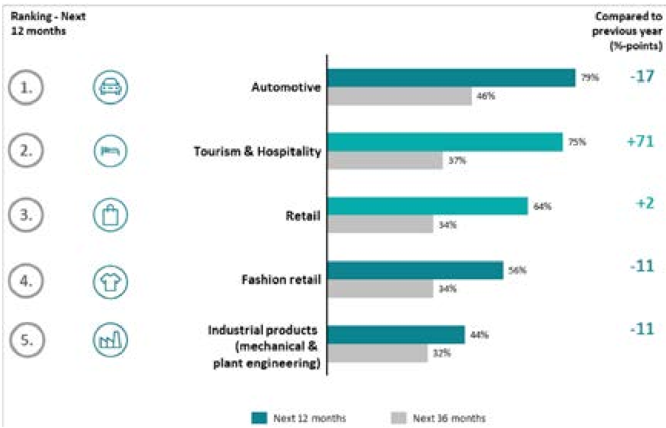
In a recent Deloitte study focussing on Distressed M&A, restructuring experts were asked what developments they were expecting in the next 12 months. Their answer was clear. The majority (83 per cent) expected a moderate to significant increase of distressed M&A transactions. Compared to a similar previous study, the number of participants expecting 'significantly more transactions' had tripled – a remarkable development.

More than two-thirds of the respondents to the survey population expected the increase to last for the next 12 months or even longer. Only one per cent expected a short sharp increase of less than three months. Interestingly, more respondents with a private equity background (46 per cent) expected an increase for more than 12 months, compared to 18 per cent of managers.

We also asked participants in which sectors they expected distressed M&A transactions to occur. More than two-thirds of the experts expected most to occur in the automotive sector. As well as retail and fashion followed closely.

Figure 13. Expected increase in the number of distressed M&A transactions in the next 12 months

Top 5 (Feedback in %; multiple choice possible)



Source: Distressed M&A Study 2021 (Deloitte 2021)

Orchestrating the Recovery from COVID-19

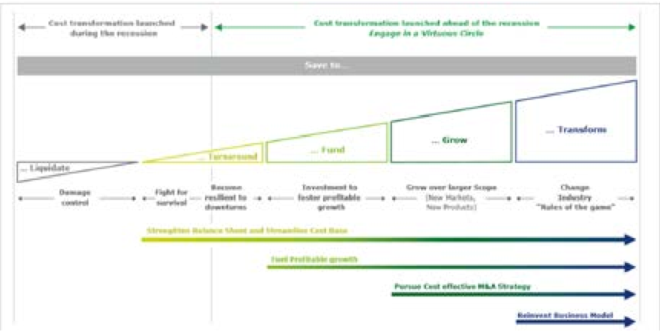
The priority of business leaders at the outset of the COVID-19 pandemic was focused almost exclusively on how to respond. However, given the prospect of emerging eventually from the crisis, leaders have had to consider all three time frames: respond, recover, and thrive, and allocate resources accordingly. Many companies established a central team or crisis management centre during the response phase to assess the immediate impacts and provide directions and information to employees, customers, suppliers, and broader ecosystem partners about immediate actions to mitigate risks. However, resilient organisations have gone further and have looked for clues about the shape the recovery could take and have established flexible plans for the recovery. When the company prepares for and shapes the ’next normal’ it has the potential to thrive again.

To plan for the recovery, companies have dealt regularly with business units individually and laid down a cost transformation programme in response to the pandemic and sets the basis for the recovery and thrive stages, as depicted in Figure 14.

The journey will depend on the company’s natural business cycle and the effectiveness of its cost transformation measures.

- **Liquidate:** The business unit is no longer a strategic priority and/or the benefit from the business is greater than from implementing a turnaround and potential sale.
- **Turnaround:** The business unit is fighting for survival or to become resilient to the downturn via a stronger balance sheet and streamlined cost base.
- **Fund:** The business unit has achieved a streamlined cost structure and can deploy capital in strategic assets to fuel profitable growth of existing operations.
- **Grow:** The business unit has enough liquidity to enter new markets or expand the product portfolio, and increase the scope of business operations via a cost-effective M&A strategy.
- **Transform:** The business unit is in a position to take on higher risk and test new business models that can change the ’rules of the game’ of the industry.

Figure 14. Cost transformation programmes



Source: Business in Volatile Times | Recession or not: Are you ready to thrive? (Deloitte 2019)

At the height of the pandemic the businesses most affected quickly found themselves in a turnaround scenario, in which it was crucial to act quickly to ensure focus and secure financing.

Despite the uncertainty resulting from the pandemic, management teams have required a sound basis for decision-making and a strategic options review proved to be an effective tool for crisis management.

Strategic Options: Fix, Sell or Close

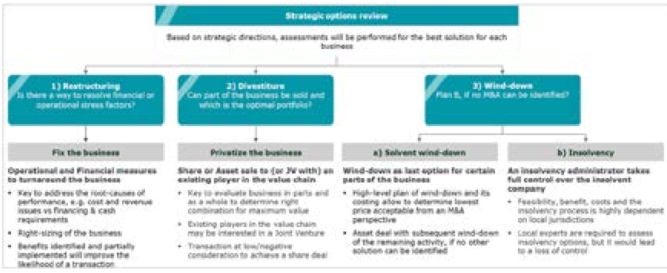
A strategic options review entails a detailed assessment of the opportunities available for a distressed company, their implications, and a recommendation or decision by management. The review is undertaken in close consultation with clients to determine the optimal way forward, but at the same time retaining an independent and objective perspective.

Having defined the criteria for success the options are assessed on the basis of timing, resources, cost, liquidity, liabilities and the risk involved along several dimensions, such as operational, commercial, financial, tax and legal, reputational, and regulatory. The recommended option will include preliminary contingency plans for the key risks, outline indicative timelines and resource requirements, and assess the implications of choosing the option from a liquidity and financing perspective.

The strategic options comprise:

- Restructuring option: Fix the business
- Divestiture option: Sell the business or parts of it
- Close option: Wind-down or liquidate

Figure 15. Strategic options



Source: Deloitte analysis

Unfortunately, we have seen many cases where the options are considered and executed in sequence. Initially, the company tries to restructure its distressed business. Soon after, it then explores M&A options. And if that fails, winding down or liquidating the asset is the only remaining option. Such a process not only leaves money on the table, but also occupies management attention for a long period of time. It is therefore best practice to assess and evaluate all the options prior to making any decision.

Restructuring Option – Fix the Business

The restructuring option entails operational and financial measures to turn it around and right-size the business by addressing the root causes of poor performance. The aim is to fix the business and initiate a recovery and drive the transformation or to prepare it for divestment in the case of a non-core asset.

Rapid Performance Improvement Framework

Typical restructuring levers are revenue growth, cost reduction, and working capital optimisation measures. These are described in the Rapid Performance Improvement framework, for example, as shown in in Figure 16. This is as an end-to-end, enterprise-wide scan and triage approach across all areas of the business, to identify and execute opportunities that drive EBITDA and cash flow on a rapid and sustainable basis.

Figure 16. Rapid Performance Improvement

Source: Deloitte

PE Lens

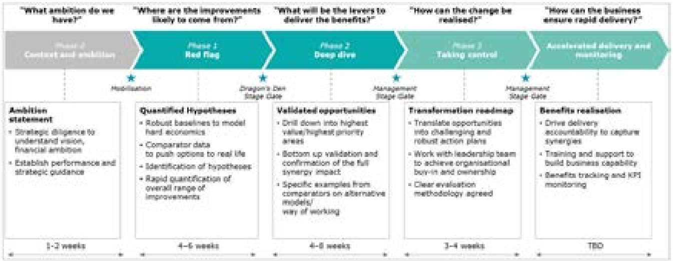
Identifying performance improvement levers can be particularly effective when applying an outside-in perspective, and looking at the mind-set of an investor, such as a private equity firm, without restricting the opportunities or challenging their feasibility with existing 'legacy' thinking. Our PE Lens approach has been developed for corporates, financial institutions and private equity (PE) – applying lessons from Deloitte's experience in working with private equity firms on value creation and strategic options.

The primary purpose of this approach is to identify rapidly the bottom-line value potential of the business, and the underlying levers to unlock that value. In a strategic options context, this rapidly establishes transparency of performance and guidance on the timeline to improving profitability – ultimately helping to accelerate decision-making about which strategic option(s) to pursue and how to maintain stability in the time available.

Our approach is modular, spanning from an outside-in approach to implementation and tracking (see Figure 17). In practice, the PE Lens approach provides transparency that executives, boards and investors can leverage as input into their strategic options decision-making.

- Red Flag: This establishes the case on value potential, defines the timeframe available (cash/capital requirements, planning and stakeholder alignment), and provides a clear view of the value of the 'restructure' and 'divestment' options. The output includes financial and FTE baselines; quantified value upside based on comparator performance; and improvement hypotheses for every management function in scope.
- Deep Dive: This is a bottom-up assessment of the operational hypotheses to validate the outside-in quantification (for the prioritised strategic option(s)) and to provide clarity about the path forward once any immediate urgent problems have been resolved.
- Taking Control: This involves planning and stakeholder alignment across the business to develop practical plans and accelerate the implementation of the chosen strategic option – working directly with executive committee and board to ensure a clear plan is pursued and to provide comfort to investors and creditors.

Figure 17. The PE Lens approach



Source: Deloitte

Asset Efficiency

With the restructuring option and from an asset efficiency perspective, it is imperative to manage liquidity and address under-performing assets. A lean asset structure will drive a lean cost structure. A six-step asset efficiency approach to help companies re-evaluate and improve the performance of their entire balance sheet assets portfolio has successfully been applied in these situations. (Figure 18)

Figure 18. Asset efficiency

Source: Deloitte

The first two steps in the approach focus on cash and trade working capital optimisation. Trade working capital is the fuel that keeps companies running; it is also the best and cheapest source of capital when the cash conversion cycle is optimised. Our experience shows that a working capital improvement programme (compliance, process, commercial, financial and structural improvements of receivables, inventories and payables) can release up to 30 per cent of the cash tied-up in business operations, much of this within three and nine months.

Steps 3 to 6 in the approach address how a company can improve its fixed and intangible assets turnover ratios.

- With regard to recent events, businesses need to reassess their fixed assets and long term leases/rental commitments against an ever-changing market. This activity should be at the core of every company's operations and commercial and financial strategy, and revisited regularly: make vs buy, own vs rent, manage vs outsource.
- Maximisation of the available capacity of existing assets should be considered next. This can take several forms: improve quality, which reduces production costs and throughput; improve cycle times, which also leads to an increase of throughput; improve scheduling and changeover times; minimise the impact of bottlenecks in factories; improve asset availability through better maintenance schedules.
- Moving on, reviewing the manufacturing footprint, repurposing facilities and factories, disposing of surplus assets, shrinking capacity or relocating has to become a business-as-usual activity.
- The final step focuses on how to 'sweat' existing assets. Excess capacity does not always have to be taken out. Sweating the assets is an area for sales teams to get creative, with tactical initiatives in order to fill the excess capacity more profitably fill, through: price points that increase both volume and contribution margin; white labelling and contract manufacturing; higher service levels such as lead time reduction; and other capacity-consuming value adding activities such as product customisation.

Divestiture Option: Sell the Business or Parts of it

The divestiture option in most cases is either a complete or a majority sale of the company or often a subsidiary or portfolio company of a larger group, to a third party. Potential buyers are typically either strategic players or financial investors. The former may be direct competitors, or other players in the value chain or adjoining sectors. Financial investors consist of (distressed) PE funds, family offices and industrial holdings. A management buy-out (MBO) can also be a valid option.

The seller may also assess the merits of setting up a joint venture with another strategic player. Joint venture endeavours should be analysed despite the fact that they are usually more time consuming, complex and risky than a straight M&A process. In many cases, when two problematic business units are merged, certain synergy cost savings are realised, but the strategic problems of the combined businesses are often not resolved.

As a first step in considering this option, the seller needs to assess whether the business unit or subsidiary is a core or non-core activity. This assessment should be made solely from a strategic point of view. This is important, because too often the decision process seems to be tainted by the current performance of the asset and all under-performing assets are automatically declared 'non-core'.

The main issues to consider when evaluating the divestiture option include:

- Buyer's universe: Who are the potential buyers?
- Equity story: Why should potential buyers be interested?
- Valuation: How much is the business worth?

Furthermore, the potential seller needs to decide on several value-influencing aspects, including:

- Scale of investor approach (Bilateral process vs broad auction)
- Timeline for transaction (Accelerated vs regular process)
- Timing of transaction (Un-restructured vs fully restructured)

One of the most challenging questions concerns the timing of the transaction. Whether to sell the business either 'as-is' or fully restructured depends on the risks of a successful restructuring and the buyer`s risk appetite.

There are generally four potential exit stages (Figure 19):

- 'Fully unrestructured' stage: Selling the company 'as-is'
- 'Initiatives identified' stage: Having identified but not implemented restructuring measures, which are integrated into the business plan
- 'Cost-saving initiatives implemented' stage: Restructuring measures on the cost side and 'quick wins' are implemented and results can be seen in current trading performance. The liquidity and operational crises have been dealt with.
- 'Business model (fully) restructured' stage: The strategic crisis of the company has been overcome by a transformation of the business model.

Figure 19. Exit stages

Source: Deloitte

The potential buyers of a distressed asset will increase in number the further the restructuring has proceeded. Strategic investors will normally be hesitant to invest in a fully un-restructured company, since they do not want to execute a restructuring themselves. In addition, among financial investors distressed funds will have a look at an unrestructured target.

On one hand, valuation levels will increase, as the effects of a restructuring can be seen in performance figures. On the other hand, the risk of delivering a successful turnaround stays with seller. In many cases taking initial restructuring measures to obtain 'quick wins' is a preferred option.

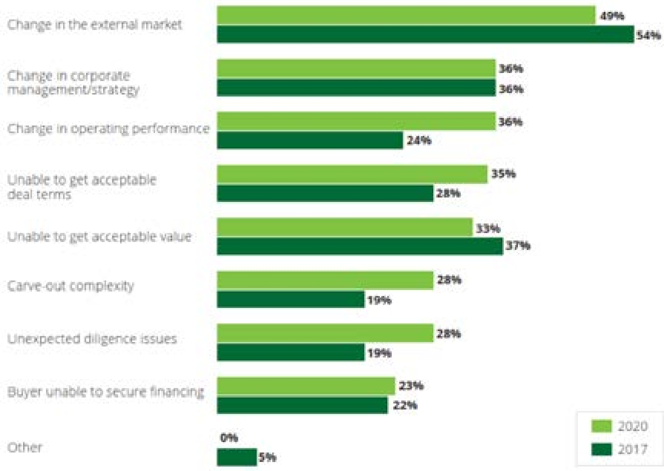
A divestiture should not be rushed. Thorough preparation of the M&A process is value-maximising and can help filling buyer and seller expectation gaps. The required steps can include:

- Set-up stand-alone financials (historicals + business plan)
- Prepare an operational carve-out
- Collect information for the data room.

According to the Deloitte 2020 Global Divestiture Survey (Figure 20), after changes in market environment and corporate strategy, the biggest hurdles to divestitures that respondents anticipated in 2020 were changes in operating performance (36 per cent), inability to negotiate acceptable deal terms (35 per cent), and inability to obtain acceptable value for their assets (33 per cent).

Further, on the basis of the transaction experience gained by Deloitte over the years the expectation gaps between buyer and seller are generally caused by additional challenges such as lack of clarity about manufacturing services agreements, transition services agreements, and working capital in purchase agreements. While many believe that these agreements can be completed close to signing, a seller would benefit by aligning them internally and build a supporting narrative well in advance.

Figure 20. Biggest hurdles in the context of divestitures



Source: Deloitte, 2020 Global Divestiture Survey and 2017 Corporate Divestment Strategy Survey

Close option: Solvent wind-down or Insolvency

The wind-down or liquidation option must be considered as the last resort. This option should be included in the strategic option review, since there are cases where this is (unfortunately) the only rational solution. However, having developed an understanding of the expected wind-down costs informs the M&A negotiations and the decision making on whether or not to move forward with a transaction.

Generally, the following options can be considered for a wind-down:

- Solvent wind-down
  - by the original owner of the company
  - by a third party after a sale to a buyer that will liquidate the company (also known as 'paid funeral')
- Insolvency

Solvent Wind-down

The winding process usually starts with a comprehensive plan, with the following components:

- Operational closure strategy, including employee considerations, asset realisation and customer retention
- Detailed Day 1 communication plans (media, PR and reputational issues)
- Stakeholder management, e.g. clients, employees, suppliers
- Wind-down financial forecasts and baseline, including actual and contingent liabilities as well as cash and trading forecasts, and working capital projections
- Tax reglatory and legal implications
- Solvent liquidation of legal entity
- Detailed wind-down plans with key actions and milestones, and
- Set up PMO and internal reporting.

A solvent wind-down can be more complex than expected in light of the myriad issues that need to be addressed, as shown in Figure 21.

Figure 21. Factors defining the complexity of a wind-down plan

Source: Deloitte

Paid Funeral

A so called 'paid funeral' may be another option. With this option, the company is being sold 'as-is' to a buyer, who will continue the loss-making activities for a certain time before putting it into liquidation. The advantage of such an option for the seller is that it will not have to undertake the often complicated wind-down process itself. However, this benefit comes at a price: the buyer usually expects a negative price that covers the expected losses as well as the liquidation costs. Furthermore, the buyer usually expects its 'services' to be covered, together with a risk premium, making this alternative unattractive in many cases.

Insolvency

An insolvency should also be considered. With this option, the company is placed in a formal insolvency or bankruptcy process. Since the details of this option depend on the insolvency legislation in each country, we discuss this option here only in general terms.

The appeal of this option from a shareholder perspective might be that losses are cut with immediate effect. For this reason larger corporates consider this option — before discarding it after a more careful thought. There are several reasons why we see hardly any insolvencies of subsidiaries:

- The administrator takes full control over the insolvent company and decides on continuation or cessation of the business (unless the process is done under self-administration as referred to below).
- There is a risk of clawback of repayments of shareholder loans prior to the filing for insolvency.
- Corporates often see reputation risk affecting stakeholders such as employees, customers, suppliers, banks and other financing partners.

From a legal viewpoint, during 'self-administration' the debtor retains possession of the assets while the business undergoes reorganisation. The aim of self-administration proceedings is to retain the responsible and capable management of the organisation and to minimising outside interference. Self-administration proceedings are normally used in the context of a restructuring, driven by a court's insolvency process. In these situations, the management remains in place, in order to maintain relationships of trust with customers, suppliers and employees. This is essential to make a restructuring successful[6].

Outlook

In recovering from the COVID crisis, difficult decisions and choices will continue having to be made. There may be a lack of clarity about options for the way forward, and the framework and approaches illustrated above will support management teams, board members and shareholders alike to consider a full range of options for dealing with the challenges around underperforming or distressed companies that exist, making crucial decisions, and implementing them rapidly.

[6] Source: Clifford Chance LLP

GERMANY: WHEN IN GERMANY DO AS THE ENGLISH DO?

Introduction

2021 has started with the most profound innovation for German restructuring law for over two decades.
Calls by many German restructuring experts and insolvency practitioners for the introduction of a formal out-of-court restructuring regime have long not been heard by the legislator. So, it was for the EU to set the tone. The new EU Restructuring Directive (Directive (EU) 2019/1023 of 20 June 2019) for the harmonisation of restructuring frameworks in Europe[1] was the path maker for the German restructuring law reform. The EU-Directive has been implemented into German law with the so-called Law on the further development of restructuring and insolvency law (SanInsFoG) as of 1 January 2021[2]. Hence, Germany is the second country in the EU (following Greece[3]) that has already adopted the EU Directive.

And the German law provides for a fundamental shift in restructuring law. For the first time ever, an out-of-court restructuring regime has been implemented that allows cram down of dissenting creditors.

Besides, as a result of the COVID-19 pandemic and aiming to mitigate its economic effects, certain obligations to file for insolvency have been suspended in Germany. While most of this interim legislation has ceased on January 1, 2021, in some cases insolvency filing obligations have been suspended until 30 April 2021[4].

So, let's have a closer look at the German insolvency and restructuring market:

I. Is German Economy in crisis?

GDP has declined by 5 per cent in 2020 compared to 2019 due to the COVID-19 pandemic. For the first time since the financial crisis in 2008/2009 the domestic economy moved into a recession. The pandemic also stopped the continuous growth of gainful employment in Germany that had had occurred over the last 14 years. The unemployment rate increased in 2020 to a total of 5.9 per cent. This is the first increase since 2013 and still a very low number compared to unemployment rates over the last 25 years[5]. The state budget for 2020 shows a financial deficit of appr. 140 billion Euros which is the second highest deficit since the German reunification and the first deficit in 10 years[6].
However, mainly because of the suspension of insolvency filing obligations, the number of corporate insolvencies continued to decline. 16,300 companies filed for insolvency in 2020 which is a decrease of 13.4 per cent in comparison to 2019. This trend was also supported by the fact, that the German government adopted numerous aid and support measures for the economy. Mostly small companies profited from these supports[7]. Thus, insolvency activity as a seismograph for overall economic development has become decoupled from the true state of German companies in 2020.

Andreas Dimmling
GSK Stockmann

A: Karl-Scharnagl-Ring 8, 80539 Munich, Germany
T: +49 89 288174 73
F: +49 89 288174 44
E: andreas.dimmling@gsk.de
W: www.gsk.de

Andreas Dimmling is a restructuring and corporate partner in the Munich office of GSK Stockmann and co-heads the insolvency and restructuring group of GSK Stockmann. Since 2009, Andreas has advised national and international clients on restructuring and insolvency matters, including distressed mergers and acquisitions, corporate restructuring, insolvency proceedings and out-of-court restructurings. Prior to working in Munich, Andreas was based in the Berlin and Heidelberg offices of GSK. He gained intensive international experience through secondments in London and Barcelona and during university studies in Italy and New Zealand. Andreas holds a law degree and a business degree from the universities of Berlin and Bayreuth and undertook his legal traineeship in Berlin.

Sandra Krepler
GSK Stockmann

A: Karl-Scharnagl-Ring 8, 80539 Munich Germany
T: +49 89 288174 73
F: +49 89 288174 44
E: sandra.krepler@gsk.de
W: www.gsk.de

Sandra Krepler is a restructuring and corporate associate in the Munich office of GSK Stockmann. She has been involved in many restructuring and insolvency cases with a particular focus on international or fund assets situations since 2019. Sandra was trained at the university of Regensburg and the Trinity College of Dublin. Sandra holds a law degree and a Master of Law degree on European and International Business Law (Trinity College Dublin). Sandra is also fluent in Spanish following a secondment in Buenos Aires.

1. See Section V.ii for more details.
2. See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L1023.
3. The Netherlands also have introduced a new restructuring law taking in the EU-law. However, the Netherlands law is not a formal implementation of the EU-Directive.
4. See Section V.i for more details.
5. See https://de.statista.com/statistik/daten/studie/1224/umfrage/arbeitslosenquote-in-deutschland-seit-1995/#professional
6. See https://www.destatis.de/EN/Press/2021/02/PE21_082_81.html, last visited on Feb 28, 2021
7. See https://www.creditreform.de/aktuelles-wissen/pressemeldungen-fachbeitraege/news-details/show/insolvenzen-in-deutschland-jahr-2020

GSK STOCKMANN

II. Which branches are the most vulnerable for insolvencies?

The German economy is experiencing insolvencies particularly in the retail (like Karstadt) and in the systemic gastronomy sector (like Vapiano) and the touristic sector(Thomas Cook). The Thomas Cook insolvency is somewhat special as it occurred even before COVID-19. In September 2019, the Thomas Cook Group filed for insolvency in England and ceased operations on 23 September 2019. Shortly after, the German subsidiaries filed for insolvency as well[8]. At the time of insolvency, around 140,000 people were travelling. The German and British Government organised the largest repatriation of citizens abroad since the Second World War. Interestingly, the German government announced on 11 December 2019 that it will compensate for payment defaults resulting from the insolvency of those companies to package travellers[9], if they are not compensated by third parties. In return, the German government will have any claims of the package travellers against those companies assigned to it so that it can pursue these claims in a concentrated manner and, if necessary, take legal action[10].

III. What is the most interesting insolvency case in Germany at the moment?

Let me think… No, there is no doubt at all. The winner is Wirecard AG. The insolvency of Wirecard AG is the biggest financial scandal in Germany for decades. Wirecard had been a German unicorn for a modern, tech-orientated digital company in Germany which outnumbered many classic financial institutions and was highly regarded by politicians and market observes[11]. Wirecard was valued more than 21 billion euros at the end of 2018[12]. By now it is worth nothing. Wirecard had to admit that approximately 1.9 billion euros in its accounts did not exist, a lot of the bookkeeping was incorrect. Wirecard's former managing directors are held on remand by German prosecutors or are on the run. The scandal also forced changes within the Federal Institute for Financial Services Supervision (BaFin). There are rumours that foreign intelligence services had been involved in the betrayal of Wirecard and more revealing of unpleasant details are to be expected.

IV. How does the German Government fight the COVID-19 impacts regarding insolvency law?

The German lawmaker passed a law titled Act on Mitigation of the consequences of the COVID 19 pandemic in civil, insolvency and criminal proceedings on 27 March 2020, which came into force retroactively on 1 March 2020. Under this Act, the directors' obligation to file for insolvency immediately after over-indebtedness or illiquidity occurs had been temporarily suspended until December 31, 2020. For companies which have not received their legitimate aids, the suspension is still in place in case of illiquidity until 30 April 2021. However, the suspension does not apply where the insolvency is not a consequence of the pandemic or where there is no prospect of remedying the insolvency[13].

V. What is the big deal about the new German restructuring law?

It is a pinnacle of German restructuring and insolvency law, that if insolvency is at the doorstep and not all creditors are on the same page for a restructuring plan, the best option is a formal in-court insolvency proceeding. As a consequence of insolvency, trust of the market regarding the company was usually destroyed and nine point five out of ten corporate insolvencies ended with the liquidation of the insolvent company (often paired with a sale of the assets). Thus, German insolvency practitioners felt that German insolvency law is not competitive to foreign insolvency laws that provide for better in-court and out-of-court restructurings such as the English schemes. Following a first reform in 2012 (so-called ESUG reform of German insolvency law), the self-administration tools and influence on the appointment of insolvency administrators for debtors and creditors had improved, and an umbrella protection proceeding as a special feature of self-administration aimed at an in-court restructuring has been established.
However, still German insolvency law lacked a proper and formal out-of-court restructuring tool. Cramdown proceedings in out-of-court restructurings were not possible under existing law.

On 20 June 2019, the European Parliament and the European Council passed the Directive (EU) 2019/1023[14], which, inter alia, contains the introduction of preventive restructuring measures to avoid insolvencies at an early stage in the process. This forced the German legislator introducing a proper out-of-court restructuring tool.

Since January 1, 2021 the Directive has been transferred into German Law. The core of the SanInsFoG is the Act on the Stabilisation and Restructuring Framework for Companies (StaRUG).

1. Who can make use of the new law?

The StaRUG-law is available for all companies that are not insolvent but illiquidity is threatening. This means that it is likely that illiquidity will occur within the next 24 months. The company will need to make plausible efforts to prove that such situation occurs without illiquidity has already taken place.

8. See https://www.bmjv.de/SharedDocs/Artikel/DE/2019/121119_ThomasCook.html.
9. See https://www.focus.de/finanzen/boerse/thomas-cook-pleite-endgueltiges-aus-fuer-den-reiseveranstalter-marken-werden-eingestellt_id_11241230.html.
10. See https://www.bmjv.de/SharedDocs/Artikel/DE/2019/121119_ThomasCook.html.4.
11. See https://www.it-times.de/news/wirecard-die-ganze-geschichte-kurz-erzaehlt-135861/.
12. See https://www.boerse-online.de/nachrichten/aktien/wirecard-aktie-vor-dax-einzug-warum-man-den-wert-haben-muss-1027512735 and https://www.focus.de/magazin/archiv/wirecard-dax-eintritt-ist-der-erste-schritt_id_9547642.html.
13. See https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/DE/FH_AbmilderungFolgenCovid-19.html.

2. What is the basic principle

The basic principle of the StaRUG is that a company offers a restructuring plan to creditors. The company can choose if all creditors shall take part in the plan or only certain groups of creditors. The plan is drawn up by the company and presented to all involved creditors. The creditors shall then vote on the plan divided into different groups. If a sufficient majority of 75% of the debts to be restructured vote in favour of the plan, even dissenting creditors or dissenting groups shall have no power to prevent the plan from becoming effective (cross-class cram down effect).
During the phase of the restructuring plan being drawn up and voted on, the company can seek certain standstill measurements through court order. As a consequence, creditors cannot take legal action against the company during this time for immediate enforcement of debts.
The restructuring plan will in most cases be drawn up under the supervision of a restructuring expert who shall be appointed by the court if the debtor or a minority of at least 25% of creditors ask for. The restructuring expert can be a lawyer experienced in restructuring cases. He may have also monitoring and moderating tasks between the company and creditors.

3. What can be restructured?

Basically, all existing debts of the company safe for debts towards employees. Additionally, also shareholders' rights can be restructured and debt-to-equity swaps are possible.

4. Can existing agreements be changed in favour of the debtor?

Yes and No. Existing agreements cannot be terminated against the will of the creditor.

Furthermore, the restructuring plan cannot change the principle obligations of the debtor under existing agreements, i.e. in a lease contract the lease cannot be lowered for the future.

However, the law provides for a possibility to change "ancillary provisions" of existing contracts. There is some uncertainty what falls within these ancillary provisions. In most cases these provisions will be financial covenants or similar conditions in financial agreements that lead to certain rights of the creditor. It is yet to be determined what kind of other provisions could be amended as well.

5. Is the Restructuring Plan a complete out-of-court proceeding?

It can be if the debtor and the creditors agree. However, e.g. if certain effects of the plan shall have effect also against dissenting creditors, some level of court involvement will be necessary. Therefore, it is an out-of-court restructuring that will show some court-involvement in most cases.

6. Who makes use of the new law?

At the moment, we do not know. The law is still very new and ongoing cases are not published in any federal gazette. We assume the new law will predominantly used by larger companies that have sufficient financial measures and professional expertise to follow the steps. Companies with complex debt structures and certain groups of creditors that shall make certain consents but have denied it before, will be the first ones to use the new tools. Sectorwise, it is likely that some retail companies, automotive suppliers and also hotel or touristic companies that suffered deeply from the COVID-crisis will particularly make use of the new law.

7. Do the Germans as the English do with the new law?

The new law introduces more flexibility to the German restructuring market and opens the door for similar outcomes as within Scheme-of-Arrangements or (since June 2020) Restructuring Plans in England. However, in particular Schemes of Arrangement allow for even more harsh changes to creditors' rights (in particular change of existing amendments). Hence, the English scheme of arrangement that has been a role-model to some extent to the EU-Directive has now been transformed into a German version. So, when in Germany you do not exactly as the English do when it comes to restructuring, but many restructuring experts familiar with English restructuring measures (and in particular with the newly introduced Restructuring Plan in June 2020) will find it easy to adopt to the German new scheme. Finally, two reasons to do the restructuring the German way instead of the English way may be: First, although the new German restructuring plan requires professional assistance, costs involved should be still considerably lower than reaching out for a Scheme of Arrangement in London. Second, Schemes of Arrangement are not recognised in Germany as insolvency procedures and therefore the stipulations of a Scheme of Arrangement are not easily enforced in Germany. So, when it comes to German creditors, the German restructuring plan may be the more effective option.

IV. What Brings the Future?

From the pub around the corner to the global corporation: The Corona crisis is dragging companies of all sizes into insolvency. Emergency aid or emergency loans are often just a drop in the bucket when revenues have fallen to almost zero due to the pandemic, but high expenses for rents and wages continue. This applies above all to companies that were already struggling financially. The new introduced measures by the StaRUG may not help every company and prevent the expected wave of insolvencies. Furthermore, some rules will need to be evolved in practice. However, these uncertainties come with every new regulation and the German insolvency experts are happy to have a new tool in their box.

And even more: The COVID-19 pandemic will serve as a catalyst to speed up transformation processes towards more digitalisation and away from old traditions in the German industry. This will have an impact on insolvency figures in the coming year.

14. The full directive can be accessed via https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1023&from=de.

INSOLVENCY AND CORPORATE REHABILITATION IN ISRAEL - TOWARDS A NEW ERA

The enactment of a new and modern insolvency law coupled with the implications of the coronavirus crisis, could lead to a material change in the way insolvency proceedings are conducted in Israel.

The State of Israel is on the verge of a revolution with respect to insolvency and economic rehabilitation proceedings. In September 2019, the new law came into effect - the Insolvency and Economic Rehabilitation Law, 5778-2018 - which regulates the area of insolvency in an advanced and modern way, seeking to conform with the current economic and business reality.

The Law (and the regulations to be promulgated thereunder) assumes that repayment default risk is an inseparable part of using credit, and therefore the legislative-legal treatment of insolvency must be integrated within the field of credit, in its broadest sense. In this context, insolvency law should create certainty for players in the business market, reflect society’s values, and be suitable for modern economic reality.

By recognising that events of default are an integral part of the credit “life cycle”, it shall be possible to lay aside the general reproach customarily attributed to debtors that defaulted on their obligations. As a result, the sentiment towards the debtor - whether individual or corporate - and the manner in which insolvency proceedings are conducted, shall place an emphasis on the degree of economic expectation that could derive from its continued activity and economic rehabilitation, and not on punitive or “educational” considerations.

Indeed, Israeli law presents an approach that prefers and promotes economic rehabilitation over corporate liquidation and dissolution, and for such purpose, it defined a series of rules and provisions meant to create a climate as favourable as possible for corporate rehabilitation. Among others, the Law sets forth clear conditions for formulating debt settlements (the “Israeli” Chapter 11 or pre-pack), including provisions incentivising corporations to initiate rehabilitation proceedings in advance. In addition, legal tools have been made available to companies and managers for dealing with the need to procure new credit in the course of rehabilitation, comprehensive stay of proceedings for contending with litigation and collection proceedings, provisions that allow preserving or waiving contracts the corporation is bound by, and more.

The coronavirus crisis broke out soon after the new Law took effect and led to a dramatic increase in the number of insolvency proceedings being conducted in Israel. According to official estimates, in 2020 there was an increase of approximately 40% compared to 2019. The coronavirus crisis and influx of collapsing businesses as result thereof, increased the need for efficient management of insolvency proceedings and for finding creative and effective solutions for businesses in distress.

Adv. Dr. Itay Hass
Head of insolvency and restructuring
Agmon & Co. Rosenberg Hacohen & Co.

Itay acts on all aspects of insolvency law, including corporate rehabilitation, liquidation, directors and officers liability, individual debtors (bankruptcy) and receivership.

Itay previously served as director of the legal department of the Administrator General and Official Receiver Unit of the Ministry of Justice, and was heavily involved in formulating the Insolvency and Economic Rehabilitation Law, 2018.

Itay is frequently appointed by the court as Trustee for companies in a verity of sectors. Among others, Itay was appointed trustee over the assets of Co - op Israel Ltd., the owner of a chain of super-markets, as join trustee of the large construction company U. Dori Construction Ltd. that has collapsed leaving a debt of 1.3 Billion ILS, and as receiver of real estate in Tel-Aviv valued ILS 250,000,000.

Itay serves as a leading lecturer on insolvency law at the Hebrew University of Jerusalem and at Sapir Academic College.

> The State of Israel is on the verge of a revolution with respect to insolvency and economic rehabilitation proceedings.

Overview - Insolvency Proceedings in Israel

There are three tracks for corporate insolvency proceedings in Israel - a voluntary creditors' arrangement track, an economic rehabilitation track while continuing operations, and a liquidation track. In total, approximately 1,000 companies are involved in insolvency proceedings on average per year, in the various tracks, the vast majority of them in the liquidation track.

> In total, approximately 1,000 companies are involved in insolvency proceedings on average per year

In the liquidation track, the proceeding is designed to maximise the consideration to be received by the creditors, by way of realising assets and exhausting the rights of the company in liquidation. The law sets forth preferences for debt repayment, while secured creditors come first, followed by creditors of preferred debts - primarily certain employee rights and certain tax liabilities, and then followed by the general debts. In this track the court appoints a functionary (trustee), who has all the necessary powers to conduct the liquidation proceeding. Management's powers are suspended, and the interests of the shareholders are relinquished and in practice suspended, until all of the debts have been repaid.

The economic rehabilitation track while continuing operations has a different purpose than the liquidation track. The purpose of this track is to deal with the difficulties encountered by the corporation and formulating a business recovery plan addressing the difficulties - through raising additional credit, business focusing, streamlining, reduction or redistribution of the debts, and more. Rehabilitation proceedings are initiated with an order for stay of proceedings, and with the appointment of a trustee chosen by the court. The trustee acts in cooperation with the company's management in formulating a recovery plan and presents it to the creditors. The creditors convene according to classes in order to vote with respect to the proposed recovery plan. The required majority for purpose of approving the plan is a majority of voting creditors, who represent at least 75% of the value of the debts of the specific class. Such a majority is required for each class separately. Insofar as the creditors approve the plan, it is submitted to the court for approval, and thereafter the plan is implemented by the company's original organs, and with the trustee's assistance.

The voluntary creditors arrangement track is used for arrangements formulated outside the court, in negotiations between the company and its creditors, while the court is approached only for convening a meeting of the creditors and approving the arrangement so that it shall bind all the creditors. In this track, which is a kind of pre-pack, no order for stay of proceedings is issued, and no trustee is appointed, meaning the control over the proceeding and the company remains in the hands of its competent organs. Nevertheless, the absence of a stay of proceedings makes it difficult to use this track if the company is involved in legal proceedings or if various collection proceedings are being conducted against it (a bill is currently being finalised to allow a stay of proceedings in this track as well). The required majority for purpose of approving a creditors arrangement in this track is identical to the majority required for approving an economic rehabilitation plan, as described earlier with respect to the rehabilitation track while continuing operations. It is noted that Israeli law recognises the possibility of a cramdown on objecting classes of creditors, under certain conditions, both in this track and in the rehabilitation track.

International Insolvency Proceedings

In modern times and in the era of multinational corporations, there is great importance in principally and legally regulating cross-border insolvency proceedings. It is commonplace for a certain corporation has tangible assets in one country, intellectual property rights in another country, and business activity in a series of additional countries. When a corporation of this kind encounters insolvency proceedings, questions arise with respect to the proper forum for conducting the proceeding, the relevant substantive law that should apply to the case, the status of creditors in each country, concern of concealing property, the powers of the functionary appointed to conduct the proceeding and the manner of exercising such powers, and more.

There were a number of cases in Israel in recent years where foreign public companies, which are traded on various stock exchanges all over the world and which have assets in different countries, issued bonds in Israel. Some of these companies encountered difficulties and even insolvency, and legal proceedings in their cases required reference to international law. In addition, according to Tel-Aviv Stock Exchange (TASE) data, more than 60 companies are listed for dual trading, both on TASE and on one of the large international stock exchanges - NYSE, NASDAQ, London SE, HKEX and more. So far, issues relating to international insolvency were regulated by the courts, on a case to case basis. Nevertheless, as the global aspects of the Israeli economy expanded, it became necessary for legal regulation of international issues in the area of trade and business, including in the area of insolvency. When the Law was enacted, the Israeli legislator chose to adopt the model that was outlined by the UNCITRAL Model Law on Cross-Border Insolvency. This model was adopted by many countries around the world, and it became a well-known and accepted international standard. By its adoption in Israel, the Israeli legislator wanted to create certainty and uniformity with respect to the potential proceedings, in order to bring about an efficient and fair distribution of the assets of debtor companies between their creditors, and to encourage international investments in Israel.

According to this model, insolvency proceedings initiated outside Israel shall also be honoured (according to a motion to be filed) by the Israeli courts, and the foreign functionary that was appointed shall have direct access to the Israeli court and to the relevant Israeli authorities. The chapter discussing international insolvency proceedings in Israeli law grants powers and standing to the foreign functionary that was appointed in the framework of the insolvency proceeding initiated outside Israel, makes the standing of foreign creditors equal to that of Israeli creditors, and allows various reliefs and temporary reliefs to be granted (including stay of proceedings, realising assets, and more).

Change to the Standing of Creditors

An important novelty in the Israeli insolvency law, which could also be of significance for international creditors, relates to the standing of secured creditors. In the past, secured creditors were completely independent with respect to realising collateral or securities, and they were not even required to take part in the collective proceeding. Today matters are different. A secured creditor is required to participate in the insolvency proceeding as any creditor, and certain restrictions are even imposed on it with respect to its ability to recover from security available to it. When a corporation enters insolvency proceedings and an order is granted to continue operations in order to formulate an economic rehabilitation plan, the secured creditor may be precluded from materialising security that was provided for purpose of repaying the debt towards it, upon the fulfilment of two conditions: (1) The charged asset is required in order to operate the corporation and its economic rehabilitation; (2) the creditor was given "adequate protection" which protects it in the sense that its economic condition shall not be prejudiced compared to its condition before the order was granted to continue operating the corporation. Such adequate protection may be different security, or a financial deposit. The idea behind such provisions is twofold - first, from the company's point of view, the desire is to create optimal conditions for economic rehabilitation, and it is clear that when secured creditors act independently it makes it more difficult for corporations to operate, and in practice prevents rehabilitation. Second, from the creditors' point of view, it is clear that the strength of security cannot be significantly harmed, and that such harm may be expressed through an increase in the costs of credit, and through reduced business activity. Therefore, it is necessary to balance the support of the secured creditor to the economic rehabilitation process with its protection. The idea of "adequate protection" is designed precisely for this. The legislator set forth that in order to allow reduced independence of the secured creditor in conducting proceedings for materialising its security, it must be guaranteed that the scope of protection granted to it by the security is not impaired, and the delay in repaying the debt shall involve compensation in the form of a financial source or other security, which shall suspend the creditor's standing with respect to the ratio between the debt and the value of security. It is clarified that this mechanism only exists in cases where the court shall issue an order to continue operating the corporation for purpose of economic rehabilitation, and for a time period not to exceed 9 months (subject to exceptions). In case of corporate liquidation, failed recovery procedures, or a creditors arrangement, the secured creditor shall not be restricted from taking independent action to recover its debt from the security it was provided.

Growing international characteristics of the global economy in general, and of the Israeli economy in particular, require legal adjustment and expertise also with respect to international aspects of insolvency proceedings. Israeli law took a significant step forward towards adjusting to the global economic reality, and in fact recently underwent a real revolution with the introduction of a new and comprehensive law. There is no doubt that the future will provide opportunities for implementing and examining the new arrangements, and their suitability for the economic challenges to be expected by many corporations around the world.

Israeli law took a significant step forward towards adjusting to the global economic reality

RECOGNITION OF UK SCHEMES OF ARRANGEMENT AFTER BREXIT: KEY CONSIDERATIONS FROM A LUXEMBOURG PERSPECTIVE

Executive Summary:

The English scheme of arrangement has become one of the key tools for European restructurings in the recent years. However, Brexit and the consequential disapplication of the Brussels Convention has led to a legal vacuum in the context of having such schemes recognised throughout the EU.

Whilst the Hague Convention and the Lugano Convention may, to some extent, fill this vacuum, their application presents its own set of uncertainties. Significantly, both treaties specifically exclude insolvency, bankruptcy or analogous processes from their application.

Under the current circumstances, possibly the most likely way to have an English scheme of arrangement recognised in Luxembourg is by applying to the Luxembourg courts for an exequatur recognition procedure - a relatively untested and time-consuming process. In this context, one must look into possible public order concerns on a case by case basis as well as whether seeking recognition is absolutely needed.

1. Introduction - Brexit and restructuring

As of 31 December 2020, the EIR[1] and the Brussels Convention[2] no longer applies to the UK.

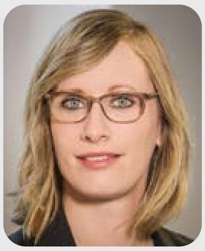
Additionally, the EU-UK Trade and Cooperation Agreement does not provide for any specific recognition or enforcement mechanism in relation to cross-border insolvencies and restructuring process following Brexit.

The impact of this is that neither English insolvency proceedings (under the EIR), nor English schemes of arrangement (previously recognised under the Brussels Convention) opened after 31 December 2020 will be automatically recognised in the EU. This gives rise to a number of significant issues for creditors in the UK as well as the EU, where the debts are incurred under an English-law governed credit agreement.

In this article, we explore the practical effects that the disapplication of the Brussels Convention presents in the context of recognition of English scheme of arrangements in Luxembourg.

2. Schemes of arrangements - beyond Brexit.

An English scheme of arrangement (a **Scheme**) is a court-sanctioned compromise or arrangement between a company and its members or creditors under Part 26 of the UK Companies Act, 2006. It is not exclusively an insolvency proceeding under English law in that it maybe undertaken in relation to both solvent and insolvent entities.



Anne-Marie Nicolas
Partner – Head of the Banking & Finance practice

E: Anne-marie.nicolas@loyensloeff.com
T: +352 466 230 314

Anne-Marie leads the Luxembourg secured lending team and in particular the leveraged and acquisition finance practice and co-leads the debt restructuring practice.

She has extensive experience on acquisition, corporate and real estate financings. Responding to a growing demand for expertise in distressed investments, lending and re-financing and debt restructurings, she advises debtors and creditors including in particular strategic advice in key structuring, insolvency, corporate governance and crisis management aspects.

Anne-Marie is the member of the New York Bar and of the Luxembourg Bar. She is also an active member of a number of key industry working groups, she is a regular speaker at Luxembourg and international panels, conferences and training sessions focusing on distressed lending and debt restructuring and the challenges encountered by those markets in the post-Brexit and Covid-19 era.

Tapobrata Mukhopadhyay
Associate – Banking & Finance practice

E: Tapobrata.Mukhopadhyay@loyensloeff.com
T: +352 466 230 513

Tapobrata is a member of the banking & finance practice group in Loyens & Loeff's Luxembourg office.

He focuses on transactional banking-specifically acquisition and leveraged finance as well as debt restructurings and re-financings. He advises lenders and sponsors and regularly acts for banks, financial institutions, corporates and investors.

Prior to joining Loyens & Loeff , Tapobrata worked at a global law firm in London. Tapobrata also has experience of working as a lawyer in India and the Middle East.

[1] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings.
[2] Regulation (EU) No. 1215/2012 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (recast).

At a high-level, it is a mechanism by which an English court can sanction a compromise or arrangement with a company's creditors subject to the approval of the compromise by a majority in number and 75% in value of each class of creditors.

It has been one of the most important mechanisms in recent European restructurings and it is likely that it will continue to do so in the post-Brexit world, provided that, some legal certainty can be achieved as to the recognition of its effects in the EU and whether or not, in certain instances, the requirement for a specific recognition of each Scheme under the national laws of each EU member-state can be bypassed.

2.1 Brussels Convention, or the lack thereof

Pre-Brexit, Schemes were not considered to be 'insolvency proceedings' under the EIR[3] and were purposely not included in the list of UK insolvency proceedings contained in the annexes to the EIR. Schemes thus usually relied on the Brussels Convention for their automatic recognition and enforcement in the EU.

The disapplication of the Brussels Convention, post-Brexit, has two prominent and immediate effects on Schemes:

i. An English court order sanctioning a Scheme would no longer be automatically recognised throughout the EU and its recognition will depend on each EU country's relevant local conflict of law rules; and
ii. A UK Scheme may, depending on the circumstances, be interpreted as being an 'insolvency proceeding' in EU jurisdictions based on the definition of such term under the local conflict of law rules and therefore be treated as falling outside the application of international treaties and conventions which exclude insolvency and analogous proceedings (like the Hague Convention[4] and the Lugano Convention[5]).

2.2 Hague Convention - the way forward?

The UK has joined the Hague Convention[6] [7] . In summary, the Hague Convention ensures that if a contractual document contains an exclusive jurisdiction clause, such choice of court is respected in its signatories' jurisdictions. Therefore, in theory, if a dispute based on a finance agreement with exclusive jurisdiction of English courts were to be brought in front of an EU court, it is possible that the EU court would dismiss such proceeding and ask the claimant to commence proceedings in the English courts[8].

However, applying the Hague Convention to grant recognition to an English court order sanctioning a Scheme presents the following issues:

i. For the Hague Convention to apply, the exclusive jurisdiction of the relevant court should arise as a result of contractual submission to such jurisdiction by the parties[9]. However, in the context of a Scheme, the jurisdiction of a UK court is derived from a statute[10] rather than an exclusive contractual submission by the parties to a UK court and therefore the applicability of the Hague Convention to Schemes may be debatable.
ii. '*Insolvency, composition and analogous matters*' are specifically excluded from the scope of the Hague Convention[11]. While a scheme was not considered an 'insolvency proceeding' for the purposes of the EIR, it is not clear whether recognition can be sought under the Hague Convention when a court is exercising its statutory powers to effect a reorganisation of a company to prevent insolvency or where certain effects of the Scheme (such as a creditor cram-down) may be seen by the local EU courts as essentially insolvency features (or an analogous situation, in the context of a solvent reorganisation) - this issue is especially relevant in light of the recent *gategroup* case (as discussed below) which may have opened the pandora's box in this respect.
iii. Notwithstanding (i) or (ii) above, the Hague Convention only applies to '*exclusive choice of court agreement*'. Therefore, it is unlikely that the Hague Convention would apply to a debt document containing an asymmetrical jurisdiction clause (as was typically the case in UK based financings before Brexit).
iv. There is no automatic recognition under the Hague Convention - applicants would still need to apply to the relevant national court.

In practical terms, while the Hague Convention can be a useful tool, its restricted scope is far narrower than the Brussels Convention and its application is still uncertain at present.

2.3 The Lugano Convention

The Lugano Convention[12] contains rules similar (but not identical) to the Brussels Convention. Like the Brussels Convention, it imposes rules in relation to jurisdiction, recognition and enforcement of judgments between EU Member States and EFTA states other than Liechtenstein (i.e. Switzerland, Iceland and Norway).

Although the UK is no longer a part of the EU, it has made an application in April 2020 to accede to the Lugano Convention separately.[13] All the member states party to the Lugano Convention must consent in order for the UK to be able to join the convention.

If the UK's application is accepted, it could indeed pave the way for Schemes to bridge the gap left by the Brussels Convention, to some extent. However, at the time of writing this article, a decision on the UK's application to join the convention is still awaited and so far only Switzerland, Norway and Iceland have made official statements in support of the UK's accession to the treaty.

[3] See Re Van Gansewinkel Groep BV [2015] EWHC 2151 (Ch).
[4] Supra n.11
[5] Supra n. 16
[6] The Hague Convention of 30 June 2005 on Choice of Court Agreements.
[7] The UK is now a party to the Hague Convention post 1 January 2021 by virtue of Private International Law (Implementation of Agreements) Act 2020, section 1(2)).
[8] See Article 6 of the Hague Convention.
[9] See Article 3 of the Hague Convention.
[10] Part 26 of the UK Companies Act, 2006.
[11] See Article 2(2)(e) of the Hague Convention.
[12] The Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial matters signed in Lugano on 30 October 2007.
[13] UK Ministry of Justice, 28 January 2020, *Support for the UK's intent to accede to the Lugano Convention 2007*. Available at: <https://www.gov.uk/government/news/support-for-the-uks-intent-to-accede-to-the-lugano-convention-2007> (Accessed 2 April 2021)

On the 4 May 2021, the European Commission released its non-binding recommendation to the European Parliament and the Council recommending that the EU should not consent to the UK's application to accede to the Lugano Convention.[14] While non-binding, if this is reflected in the EU's formal decision to the UK's application, the UK will not be able to accede to the Convention.

Meanwhile, a key development in the context of the Lugano Convention has been the recent decision of an English court in the *gategroup* case.[15] In its February 2021 judgement, the court held that a restructuring plan proceeding (which is similar, although not the same as a Scheme since it, among other things, can only be used by distressed entities) is within the bankruptcy exclusion in the Lugano Convention[16], i.e., essentially, that a restructuring plan proceeding (as described in *gategroup*) is an 'insolvency proceeding' and therefore the Lugano Convention does not apply to such restructuring plan proceedings.

We note that the court in *gategroup* relied on the "financial difficulties" [17] being faced by the relevant company as a threshold condition for a restructuring plan[18]. While a full analysis of the jurisprudence is beyond the purview of this article, in our view, the requirement for 'financial difficulty' is a key distinction between restructuring plan proceedings and ordinary Schemes and should put Schemes outside the ambit of the aforementioned bankruptcy exclusion under the Lugano Convention. However, it is possible that a local court in one of the EU jurisdictions may take a different view on Schemes in the coming years, thereby taking Schemes outside the ambit of the Lugano Convention.

3. Next steps and practical considerations

In the absence of the applicability of the Lugano Convention or the Hague Convention, the enforceability of a Scheme against Luxembourg-situated assets of a debtor would depend on an *exequatur* recognition procedure.

We have examined the requirements of this procedure in a previous note.[19] From our perspective, it can be expected that even if a Scheme fulfils all the requirements of the procedure and a recognition order is given, the process itself will take at least 1 year and possibly longer if opposed. The current Covid-affected economy may lead to further delays as a growing number of businesses are expected to start restructuring processes and would want such processes to be recognised overseas.

Below, we present a few significant questions that Scheme parties should consider, before bringing an *exequatur* recognition procedure in Luxembourg.

3.1 Requirement for recognition

As a first step, the Scheme creditors should consider whether it is, in fact, necessary to have the Scheme recognised in Luxembourg. At the outset, creditors should consider that since in the past parties have relied on the automatic recognition under the Brussels Convention, there is no clear jurisprudence on how a Luxembourg court might look at an application for recognition.

Given the time consideration, it is prudent to bring a recognition proceeding in Luxembourg only if an execution order is absolutely necessary (for example, if there are substantial assets in Luxembourg, or if there is a possibility of a number of disgruntled creditors bringing legal action in Luxembourg – which we have discussed in detail below).

3.2 Insolvency Proceeding

If an application for recognition is presented to a Luxembourg court, the Luxembourg court would first consider whether a Scheme can be classified as an 'insolvency proceeding' – the meaning of which will be interpreted in accordance with Luxembourg law.

While there is no clear mechanism for determining what would constitute an 'insolvency proceeding' under Luxembourg law, the court might look at recognition action taken in other jurisdictions to assess this. For example, in cases where there are assets in the US, recognition proceedings are often brought in the US courts under Chapter 15 of the US Bankruptcy Code. In such a situation, there is a higher risk that the Luxembourg court would rule that a Scheme would qualify as an insolvency proceeding.

On the flipside, it is possible that a US court grants a worldwide stay against any creditor action against the relevant entities (including Luxembourg entities). In such cases, from a practical perspective, parties with a strong US presence or US interests are unlikely to start foreign proceedings which would go against a US judgement (given the power of the US court to sanction any violation of its "universal" enforcement stay order).Under those circumstances, creditors should consider whether it is efficient or indeed required to bring a recognition proceeding in Luxembourg (usually, it is not).

The situation is however different when it comes to the jurisdiction and powers of a UK court. The intimidating effects of a US court order under Chapter 11 of the US Bankruptcy Code, and its power to stay proceedings or risk of a contempt of court situation and the related risks (including a reputational risk) have no equivalent as such in the UK and will not provide Schemes with the same quasi "impunity" which benefits Chapter 11 procedures in the US.

[14] Communication from the Commission to the European Parliament and the Council: Assessment on the application of the United Kingdom of Great Britain and Northern Ireland to accede to the 2007 Lugano Convention, COM (2021)22 final, dated 4.5.2021. Available at < 1_en_act_en.pdf (europa.eu)> (Accessed 18.05.2021)
[15] Re *gategroup* Guarantee Limited [2021] EWHC 304 (Ch).
[16] Specifically: "bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings" — Article 1(2)(b) of the Lugano Convention.
[17] Required under Section 901A of the UK Companies Act 2006.
[18] See Re gategroup Guarantee Limited [2021] EWHC 304 (Ch), at para 102.
[19] Nicolas, A. M, Guardiola, I.J. and Huskic, M. Post-Brexit recognition of English insolvency judgments in Luxembourg and its effects on European restructurings. In-House Lawyer | Restructuring and insolvency | Autumn 2020 | Legal Briefing, Available at: <https://www.inhouselawyer.co.uk/legal-briefing/post-brexit-recognition-of-english-insolvency-judgments-in-luxembourg-and-its-effects-on-european-restructurings/> [Accessed 2 April 2021].

3.3 Action by disgruntled creditors

Scheme creditors should have regard to the possibility that before a Scheme can be recognised by a Luxembourg court, a disgruntled Luxembourg based creditor who is adversely affected by the Scheme may want to bring proceedings in a Luxembourg court against the debtor.

From such a creditor's perspective, an argument can be presented that since the Scheme is no longer automatically recognised in Luxembourg, the obligations of the Luxembourg entity subject to such a Scheme remains unaffected by the Scheme and as such is due and payable.

In our view, such an argument is unlikely to succeed given that usually the underlying debt document would specify that an enforcement action may only be brought by the lender's representative (or the agent) acting on behalf of all the lenders. As such a representative would be bound by the terms of the Scheme (assuming standard agency provisions in the relevant finance documents governed by English law), it is less than likely that the disgruntled creditor would have a direct standing to bring any enforcement action.

Scheme creditors should, however, bear in mind that such disgruntled creditor's argument may succeed if such a creditor is considered by the Luxembourg court to be a direct creditor of the Scheme entity with standing. In this context, it should be noted that the initiation of a civil proceeding for recognition of a Scheme would not have the effect of providing any automatic stay on other proceedings in Luxembourg (especially not bankruptcy proceedings).

Creditors are also normally well advised to consider that the type of insolvency proceeding most used and most relevant (until further reform of the bankruptcy law to implement the EU Restructuring Directive[20]) in Luxembourg is the bankruptcy proceeding. A bankruptcy proceeding is a liquidation proceeding with a court appointed receiver and neither the sponsor nor any creditor is in a position to control such proceeding - thus it is not usually viewed by either party as an attractive or viable option.

3.4 Public order

The English courts, who are required to satisfy themselves that a Scheme would have effect in any relevant foreign jurisdiction prior to sanctioning such Scheme, can no longer benefit from the assumption of automatic recognition of their order approving a Scheme under the Brussels Convention. They would therefore need to have regard to the Luxembourg conflict of law rules for recognising a foreign-court decision.[21] One of the main requirements under Luxembourg law to recognise a foreign-court decision is that the implementation of such a decision does not violate Luxembourg public order.

The application of the concept of Luxembourg public order in the context of a Scheme remains untested before the Luxembourg courts. The Luxembourg court of appeal has previously held that the principle of equality between unsecured creditors is a matter of public order[22], so that any contrary agreement is null and void, in accordance with Article 6 of the Luxembourg Civil Code[23].

However, Luxembourg courts have also ruled that the principle of equality between creditors is not an absolute rule from which no derogation is permissible[24]. It may be allowed to treat classes of creditors differently if this is beneficial to the creditors as a whole[25]. Further, under Belgian law (which inspired Luxembourg laws on composition with creditors (*concordat préventif de la faillite*) and controlled management (*gestion contrôlée*)), court decisions have accepted that the principle of equality between creditors does not preclude a differentiation between different categories of creditors[26].

It is difficult to speculate how a Luxembourg court would treat the juxtaposition of public order and Schemes given that the assessment, in an *exequatur* context, would be made based on the practical consequences of such Scheme. For now, the preferred approach from a Scheme creditor's perspective would be to map out whether a recognition of the Scheme in Luxembourg is really necessary in light of the fact that, typically, (i) Luxembourg debtors in international debt restructurings are borrower, security provider or guarantor SPVs as opposed to operating companies with assets on the ground locally and (ii) the Luxembourg security package (typically made out of financial collateral arrangements only) is bankruptcy remote and would not need an execution action in Luxembourg in order for the enforcement to be triggered.

More often than not, it is concluded that the restructuring may maintain its course without an express recognition being sought in Luxembourg (to the extent there is no immediate bankruptcy risk taking into account the effects of the English Scheme on the English debt). The same is however not necessarily possible in other EU jurisdictions- it therefore seems that the recognition issue is going to be on all European restructuring practitioners' radars for a while.

[20] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

[21] In practice, this would often take the form of a Luxembourg law expert opinion, as was the case in the *gategroup* case cited above.

[22] Court of appeal, Luxembourg, 27.10.1993, n° 15060 and 15314 : « *Le principe de l'égalité à maintenir entre les créanciers chirographaires, consacré par la loi, est d'ordre public.* » ; J.P. Winandy, Manuel de droit des sociétés, Partie V, Le droit de la faillite, p. 983 ; S. Jacoby & M. Mehlen, « Les clauses de subordination et de recours limité en droit luxembourgeois », ALJB, p. 915-938, 2004, n° 27-14.

[23] Jacoby & M. Mehlen, « Les clauses de subordination et de recours limité en droit luxembourgeois », ALJB, p. 915-938, 2004, n° 27-14.

[24] Court of appeal, Luxembourg, – 18.01.2017, n° 11/17 IV-COM, n° 42398

[25] Court of appeal, Luxembourg, 28.01.2009, n° 34351.

[26] Court of appeal, Ghent, 08.07.1903 (P.b. 1904, II, p. 60) cited in Court of appeal, Luxembourg, 28.01.2009, n° 34351, p. 8.

A STRATEGIC RESET: RESTRUCTURING AND RECAPITALIZING CORPORATE MALAYSIA

Stephen Duar
Malaysia Turnaround and Restructuring Strategy Leader, Ernst & Young PLT
Tel: +603 7495 7878
Email: stephen.duar@my.ey.com

Stephen Duar is a Partner and the Turnaround and Restructuring Strategy Leader of Ernst & Young PLT. He has over 30 years of experience in debt and operational restructuring and the turnaround of distressed companies. He is an appointee for Corporate Rescue Mechanism, including Judicial Management, Scheme of Arrangement and Corporate Voluntary Arrangement. He has also been the appointee of many receivership and liquidation administrations, including as Court-appointed Receiver for trade-on business, disposal of assets, shareholders disputes and investigations into the affairs of companies. Stephen has extensive professional experience in various sectors including property development, manufacturing, plantation, utilities, shipping, hospitality and financial services.

A licensed insolvency practitioner, Stephen is a member of the Malaysian Institute of Accountants (MIA), the Malaysian Institute of Certified Public Accountants (MICPA) and CPA Australia. He is also a member of the Insolvency Practitioner's Committee under the MIA. In 2015, he was appointed President of the Insolvency Practitioners' Association of Malaysia (IPAM) and served the maximum two-year term. He continues to serve as an IPAM council member.

Tzai Ming Pok
Director, Turnaround and Restructuring Strategy, Ernst & Young PLT
Tel: +603 7495 7892
Email: tzai-ming.pok@my.ey.com

Tzai Ming is a Director in the Turnaround and Restructuring Strategy practice of Ernst & Young PLT. He has close to 20 years of professional experience and currently leads the Restructuring Advisory team, focusing on financial restructuring, independent business reviews, refinancing and corporate turnarounds. Prior to joining the EY member firm in Malaysia, Tzai Ming was with the EY member firm in London for six years, where he worked on a number of restructuring mandates during the Global Financial Crisis in 2008.

Experienced in both debtor and creditor advisory, Tzai Ming has worked with a range of clients, including FTSE 100 and FTSE 250 companies, operating within the UK, Europe, the Nordics and South East Asia, across sectors such as subprime lending, oil and gas, aviation, shipping, maritime infrastructure, travel and leisure, media, and property development and construction. In the last five years, he has been involved in advising complex debt restructuring of distressed corporates, representing a total aggregate debt of USD1.5b.

Tzai Ming is an associate member of the Insolvency Practitioners' Association of Malaysia (IPAM).

The COVID-19 pandemic is a black swan event that has significantly impacted people, governments and businesses across the globe. To break the chain of infection, governments around the world, including Malaysia, had imposed restrictions on people's movements. This came at the expense of the global economy that was almost brought to a grinding halt in 2020.

A year on since the pandemic and with the roll-out of vaccines nationwide, there is now a general consensus that Malaysia's economy is set to recover as early as the second half of 2021, with the Central Bank of Malaysia forecasting a 6% to 7.5% GDP growth in 2021. Corporates in Malaysia are embracing the recovery with relief and optimism - relief as the corporates have survived an extremely challenging year in 2020; and optimism as executives reassess their strategy moving forward. However, the fundamental question is whether Corporate Malaysia is ready to springboard to growth again?

The distressed situation experienced by the majority of corporates in Malaysia in 2020 was not solely due to the pandemic. Increased borrowings and declining profit trends had already emerged even before the pandemic, as shown below:

Aggregate growth or decline rate* of Bursa Malaysia-listed companies

(12%)	14%	28%
EBITDA declined from 2018-2020	Debt increased from 2018-2020	Interest cost increased from 2018-2020

Source: Capital IQ
*Based on a 12-month period to 30 September results (2018 to 2020)

Building a better working world

The analysis aggregates the borrowings, interest and EBITDA of all the 932 listed companies on the Bursa Malaysia stock exchange over the last three years. The results show that in the last three years, the aggregate debt level undertaken by corporates to fund corporate profitability has increased. The leverage trend makes sense when business and the economy are growing. But on aggregate, there is an inverse relationship between profit and debt servicing obligation, suggesting that the promise of higher profit was not delivered and there is a risk of a mismatch between the corporate's profitability and its debt obligation. In fact, the pandemic has exacerbated the risk of the mismatch and distressed situation.

Corporate Malaysia 2021 - a strategic reset

Whilst the impact of the pandemic is expected to gradually subside, the fundamental issue of a mismatch between debt obligation and profitability remains. There are two fundamental challenges that most corporates face: (i) a weakened business model in the aftermath of the pandemic, and (ii) a high level of debt obligation against unsustainable earnings. These pose real obstacles to recovery, and as such, the guiding theme in 2021 for Corporate Malaysia needs to be a strategic reset to survive the crisis and focus on the growth agenda.

In our experience, financial restructuring alone is no longer adequate in a challenging and disruptive environment. Rather, it requires a holistic solution involving the proactive delivery of short-term financial reliefs, improvement in operational efficiencies, and revamping of existing business models and debt capital structures in the longer term. In fact, recent cases have seen corporates engaging in operational turnarounds, whilst financially restructuring their balance sheets to create value. This approach preserves the corporates' business viability, giving optionality and control to design the appropriate restructuring with the aim of transforming the corporates to more agile and sustainable structures to create competitive advantage over their competitors when the economy recovers; effectively reshaping their results.

Transforming through restructuring and recapitalisation

However, considering the increased borrowing levels, a quick restructure and extend may not be sufficient to resolve the financial predicament of corporates. As part of the corporates' strategic business reset, new capital is needed to recapitalise a weakened balance sheet. Corporates need new capital to fund the transformation. But for new capital to come in, the value proposition needs to be attractive and to make commercial sense to investors. This would mean debt waiver is necessary in order to bring the debts down to a sustainable level. It is only then that the transaction becomes an attractive proposition to investors.

Two key sentiments surfaced in the second half of 2020 in terms of debt waiver and new capital injection: (i) investors expect debt waivers if they are to provide new capital, and (ii) creditors are accepting debt waivers in return for new capital. In fact, recent debt restructuring cases have shown that stakeholders are willing to accept debt waivers so long as there is commercial justification and the business is viable. This makes it attractive to investors to inject new capital to recapitalise the business.

Opportunity gap within the M&A space

The pandemic, coupled with the mismatch between earnings and debt obligations, has created the right conditions for s the mergers and acquisitions (M&As) of distressed companies with the expectation that:

1. There will be an increasing trend in distressed situations among corporates as government financial reliefs unwind.
2. Valuation is expected to be low which makes it attractive to investors.
3. Capital markets in Malaysia are accommodative in low interest rate environments.

There has been some participation from investors in the distressed space in 2020, but there has not been any marked uptick in the trends. This reflects an opportunity gap for investors and presents a unique proposition for investors to aim for first mover advantage. The trend is expected to pick up in the next 12 months as according to the 23rd edition of the EY Global Capital Confidence Barometer released in March 2021, 45% of the Malaysia respondents say that they intend to pursue M&A transactions.

The conditions are not just driven by commercial opportunities, but also by robust insolvency framework and infrastructure to facilitate M&A transactions.

A mature and robust insolvency framework

Malaysia has a mature insolvency framework and infrastructure given her experience of recessions and financial crises. The last time Malaysia faced a crisis of this scale was during the 1997 Asian Financial Crisis. More than 20 years ago, the Government of Malaysia had already recognized two key challenges:

1. The insolvency model then was introduced in 1965 and it focused on distribution of assets among creditors.
2. The absence of a rescue framework would only drive companies out of business, making economic recovery more complex and challenging.

To overcome these challenges, the Government introduced the Pengurusan Danaharta Nasional Berhad Act 1998, a legislative framework that allowed Danaharta (an asset management company) to acquire and manage assets and liabilities and to appoint special administrators to manage the distressed companies (the features were a combination of the administration frameworks of Australia and the United Kingdom and of Chapter 11 in the United States). Whilst it is no longer in use today, the interim rescue framework helped Malaysia propel back to recovery from the Asian Financial Crisis.

Since then, insolvency practitioners have worked with the Government to reform the insolvency framework. In 2016, a reformed insolvency framework was introduced, incorporating corporate rescue mechanisms to facilitate the revival of distressed corporates. The new mechanisms are as follows:

Mechanism	Description
Judicial Management	A mechanism based on UK's Administration and Singapore's Judicial Management frameworks. Distressed and insolvent companies can place the management of their company in the hands of an independent court-appointed restructuring specialist that has the experience to develop and negotiate a settlement with a 75% binding threshold.
Corporate Voluntary Arrangement	This mechanism is a cost-efficient out-of-court process where the existing management of a private company may appoint an insolvency practitioner to draw up a proposal to all its creditors as a single class and bind all creditors with a 75% approval. However, the mechanism is only applicable to a private company with unsecured lending.
Scheme of Arrangement	Any company can apply to the courts to secure a moratorium and to hold meetings with each separate class of creditors to approve its proposed restructuring, provided it obtains the approval of 75% of its creditors from each class based on their different legal rights.

In addition to the above mechanisms, the Government has also introduced a pre-emptive measure platform known as the Corporate Debt Restructuring Committee for corporate borrowers and their financial creditors to work out a viable debt restructuring plan outside of the court process. Established during the Asian Financial Crisis, the informal initiative provides standstill protection to corporates admitted into its mediation process against legal proceedings initiated by financial creditors. Corporates will be given time to develop a debt restructuring plan with the aim of binding creditors in separate classes with a 75% approval. Whilst it is only relevant to financial creditors, the initiative has been successful in accelerating debt restructuring discussions among creditors.

Legal developments: enhancement in response to the pandemic

Similar to the time of the Asian Financial Crisis, enhancement to the existing insolvency framework will be required to ensure there are practical options to distressed corporates that will be operating in a potentially new economic environment post-pandemic. In 2020, the Companies Commission of Malaysia issued its consultative document on the proposed Companies (Amendment) Bill 2020. The proposed amendments follow similar moves in the United Kingdom and Singapore to help distressed companies and ensure safeguards of creditors' interests.

Among the proposed amendments are five key changes which will be crucial in facilitating the restructuring and recapitalising of distressed corporates:

Proposed changes	Description
Rescue funding or financing	The proposed amendments introduce super priority rescue financing for schemes of arrangement and judicial management. It will certainly be an essential feature of a rescue tool that provides the necessary framework to facilitate the recapitalisation of distressed corporates and access to the required working capital. Where there is new funding secured, the court can make an order to accord super priority to this funding. The protection will incentives investors and existing financial creditors to participate in the restructuring and recapitalisation exercise. The amendment is similar to the US Chapter 11 rescue financing provisions and Singapore's super priority rescue financing features.
Continuation of essential supplies	The aim of any restructuring is to facilitate the company to operate as a going concern. The proposed changes will allow the continuation of essential supplies under existing contracts, with ipso facto clauses or termination clauses due to insolvency-related events ceasing to have effect if the corporate undertakes a restructuring.

Cross-class cramdown	The existing scheme of arrangement provisions requires a 75% approval for each class of creditors based on their different legal rights. The entire scheme is jeopardised if the corporate fails to secure the requisite vote of one class of creditors. The proposed amendments allow for a wider cramdown provision to be extended to a cross-class cramdown. The court can approve the scheme and allow certain classes of creditors to cramdown the dissenting class. This is subject to a fair and equitable principle and no discrimination.
Restraining order in a scheme of arrangement	The restraining order in a scheme of arrangement enables distressed corporates to secure protection from the courts against legal proceedings, but at times, this may be subject to challenging pre-conditions. The amendment will feature: • Automatic moratorium from legal proceedings for an initial period of 60 days to provide the distressed company breathing space as well as time to develop a restructuring plan and canvass creditor support • Subsequently, four pre-conditions must be met for an extension of the restraining order for a further 10 months. • The restraining order can extend to restraining proceedings against the subsidiary or holding company in the proposed scheme of arrangement. This allows for the entire group of companies to be protected while coming up with the restructuring plan.
Wider access to restructuring tools	Presently, the access to Corporate Voluntary Arrangement is limited to private companies with only unsecured debt. The proposed change in law will allow all companies, including public companies and those with secured debt, access to a quick out-of-court restructuring under this mechanism. Notably, Judicial Management will also be extended to public listed companies and not be limited to private companies only under the existing law.

Like the roll-out of the vaccines, the timely introduction of the proposed amendments in 2021 will offer distressed corporates the required reliefs and impetus to strengthen the conditions for restructuring and the pursuit of M&A activities.

Conclusion

The COVID-19 pandemic in 2020 has exacerbated the distressed situation of corporates in Malaysia, increasing the risk of mismatch between borrowings and earnings. As the Malaysian economy is expected to rebound in 2021, the central focus for Corporate Malaysia is a strategic reset with a renewed growth agenda.

To achieve this, corporates are reassessing their strategies, from investment portfolios to cost structures and borrowings. This will drive restructuring and recapitalization activities, with the expectation that there will be an opportunity for investors to participate in the M&A transactions of distressed companies. These activities will be supported by mature and recently reformed insolvency frameworks and infrastructures, which are expected to be enhanced further in response to the pandemic.

Stephen Duar is the Turnaround and Restructuring Strategy Leader of Ernst & Young PLT; while Tzai Ming Pok is a Director in the Turnaround and Restructuring Strategy practice of Ernst & Young PLT. The views reflected above are the views of the authors and do not necessarily reflect the views of the global EY organization or its member firms.


Are you reframing your future
or is the future reframing you?
Together we can see new opportunities and create
a new future.
Reframe your future | ey.com/reframeyourfuture
The better the question. The better the answer.
The better the world works.
EY
Building a better
working world
© 2020 EYGM Limited. All Rights Reserved. ED None.

SAUDI ARABIA INSOLVENCY LAW – KEY DEVELOPMENTS AND TRENDS

The legal landscape in the Kingdom of Saudi Arabia (the Kingdom) is undergoing a significant transformation, because of the many reforms arising from Vision 2030. The transformative Insolvency Law aims to provide a legal framework for a modernised insolvency regime in the Kingdom. The new law opens new options, so traditional multi-creditor out-of-court settlements are no longer the only viable route for settling distressed debt in the Kingdom.

Prior to the introduction of the Insolvency Law, the Companies Law addressed situations of financial distress by imposing certain obligations on a company's managers and (as applicable) directors, as stipulated in Article 150 for joint stock companies and Article 181 for limited liability companies. These Articles provide, for example, that if a company's accumulated losses exceed 50% of its share capital, shareholders' approval was required for either increasing or decreasing its share capital within a certain timeframe or otherwise voluntarily dissolving the company in accordance with Chapter 10 of the Companies Law. Failing to comply with such obligations potentially exposed managers and (as applicable) directors to both civil and criminal liabilities.

However, as with any new law, the interpretation and the practical application of the Insolvency Law is now being tested. This article briefly outlines the Insolvency Law, key developments, and related trends.

Key Features of the Insolvency Law

The Insolvency Law is personally binding over local debtors and is binding in rem over foreign or local debtors with assets within the Kingdom. The law differentiates between a debtor who is insolvent and a debtor who is bankrupt. An insolvent debtor is a natural person or legal entity who is no longer able to pay debts as they fall due (a cashflow test), while a bankrupt debtor is a natural or legal entity whose assets have become insufficient to pay off debts (a balance sheet test).

The Insolvency Law provides entities (both natural persons and corporates) in financial difficulty with four options — each on a varying scale with at one end, the most debtor-friendly, and on the other end, the most creditor-friendly — a preventative settlement, financial restructuring, liquidation, and administrative liquidation.

Preventative Settlement: A preventative settlement allows debtors to reach agreements with their creditors to settle their debt while maintaining their operations. Therefore, this option preserves the autonomy of the insolvent/bankrupt debtor through the debt-settlement process.

The new law opens new options, so traditional multi-creditor out-of-court settlements are no longer the only viable route for settling distressed debt in the Kingdom.

Salman Al-Sudairi

E: salman.al-sudairi@lw.com
T: +966.11.207.2515

Salman Al-Sudairi, principal of the Law Office of Salman Al-Sudairi and Latham & Watkins partner, is one of the leading corporate and finance lawyers in Saudi Arabia, helping local and international clients with complex corporate and financing solutions. He regularly advises banks (as individuals and as consortia) and corporate organisations on large scale restructurings in Saudi Arabia. Salman has considerable strengths in Islamic finance, with noteworthy experience advising on murabaha facilities. He helps investors, sovereigns and issuers navigate the nuanced Islamic finance market in Saudi Arabia, enabling them to access capital in the Middle East and beyond.

Salman advises issuers and financial institutions on capital markets transactions enabling clients to successfully access capital in the Kingdom and internationally. He has significant transactional expertise, handling assets in a wide range of industries. Salman has also advised numerous government entities on several regulatory reform projects resulting in new regulatory frameworks and legislation.

Amar N. Meher

E: amar.meher@lw.com
T: +966.11.207.2516

Amar N. Meher is a counsel at the Law Office of Salman Al-Sudairi and leads the finance and restructuring practices.

Amar has a broad practice which principally focuses on debt restructurings, conventional and Islamic finance across all financing areas and asset classes and Shari'ah-compliant structured products, such as derivatives and investment funds. Amar has a stand-out portfolio of leading corporate, bank and financial institution clients and has advised on numerous high profile debt financings and restructurings across various product areas ranging from the bank market to the capital markets and has earned a reputation amongst clients as the go-to lawyer for debt restructurings and structured financings in Saudi Arabia.

- **Financial Restructuring:** A financial restructuring allows debtors to agree with their creditors to reorganise their finances under the supervision of an Officeholder (as defined below).

- **Liquidation:** Under a liquidation, the assets of a bankrupt debtor are sold, and the proceeds of the sale are paid to the debtor's creditors. Following the sale of assets, the debtor ceases all operations and activities, and the Officeholder manages the liquidation process.

- **Administrative Liquidation:** Similar to a liquidation, an administrative liquidation involves the selling of the bankrupt debtor's assets, using the proceeds of the sale to pay the debtor's creditors. However, this option can only be adopted in the event that the proceeds from the disposal of the assets of the bankrupt debtor are insufficient to satisfy the expenses of a liquidation.

Key Stakeholders Under the Insolvency Law

The Insolvency Law introduces a number of key stakeholders who play major roles in each of the four options:

- **Bankruptcy Committee:** A committee formed pursuant to a ministerial resolution for a renewable period of three years, consisting of five or more experienced and qualified members recommended by the Ministry of Commerce. Under the Insolvency Law, the Bankruptcy Committee enjoys a legal personality, financial and administrative independence, and operates under the supervision of the Ministry of Commerce.

- **List of Officeholders:** A list of officeholders prepared by the Bankruptcy Committee.

- **Officeholders:** A person appointed by the Commercial Court, pursuant to the List of Officeholders, who performs duties as required by the specific option adopted under the Insolvency Law.

- **Bankruptcy Registrar:** A registrar established by the Bankruptcy Committee that records — for public notification purposes — the names of debtors who have successfully implemented an option under the Insolvency Law.

Key Developments and Trends

Since the introduction of the Insolvency Law, a number of issues have arisen with respect to how the Commercial Court and Officeholders are interpreting and applying the law, principally with respect to the following:

- **Debtor-led Filings:** There are a significant number of filings before the Commercial Court with respect to options adopted under the Insolvency Law. Such filings have predominantly been debtor-led filings, with debtors initiating such filings as a defensive mechanism to redress enforcement actions commenced by creditors and out of economic necessity.

- **Claim:** The Insolvency Law states that only creditors whose legal and contractual rights are affected by settlement proposals, including by the reduction or delay in the fulfilment of their rights, may vote in the settlement proposal. The Insolvency Law and the Rules Governing Bankruptcy Procedures in Commercial Courts do not, in principle, limit claims to only those creditors whose debts are established by a final non-appealable judgement issued by an adjudicatory body in the Kingdom. However, in certain circumstances, the Officeholder and the Commercial Court have declined to accept claims that are not evidenced by final non-appealable judgements.

- **Extinguishment of Claim:** Another challenge has been with respect to the status of creditors' claims that may not have been accepted. Even though the Rules Governing Bankruptcy Procedures in Commercial Courts provides for appealing an initial judgment of the Commercial Court, neither it nor the Insolvency Law provide for the treatment of creditors' claims that have not been accepted by the Commercial Court. Notwithstanding which the Commercial Court has held that while such creditors are not able to vote on the settlement proposal, such a creditor's claim will not, however, be extinguished. This, in turn, raises the critical question as to how such claims are to be treated by the Officeholder and the Commercial Court in view of the Insolvency Law's policy objective, which is to provide a conclusion to the financial distress of the debtor.

- **Claimed Amount:** The Insolvency Law does not provide for a distinction between funded and non-funded credit lines. Whether claims should consist of both funded and non-funded credit lines remains uncertain. Only funded credit lines, in certain circumstances, have been accepted in the claimed amount.

> The Insolvency Law provides entities (both natural persons and corporates) in financial difficulty with four options — each on a varying scale with at one end, the most debtor-friendly, and on the other end, the most creditor-friendly — a preventative settlement, financial restructuring, liquidation, and administrative liquidation.

- **Suspension of Claims:** There has been some debate among Officeholders and the Commercial Court about their respective interpretations of the extent to which claims can be suspended during a period of the suspension of claims, and whether that period extends to credit enhancement provided by third parties (namely shareholders of the debtor) and whether creditors can initiate or continue any action after the lapse of the period of the suspension of claims. Differing interpretations have led, in some circumstances, to creditors commencing enforcement action against a debtor before the Enforcement Courts — notwithstanding an ongoing option under the Insolvency Law, which has invariably led to hurdles for the enforcement action. Hence, until recently, the Insolvency Law caused some uncertainty about whether third-party beneficiaries could make demands under instruments issued on behalf of a debtor for claimed amounts and whether such demands would be subject to the suspension of claims. When the law first came into effect, both Officeholders and the Commercial Court viewed the suspension of claims as extending to the suspension of a demand under instruments such as letters of credit / letters of guarantee. However, the most recent guidance from the Saudi Central Bank has clarified that the issuers of such instruments must comply with their respective obligations under such instruments, which has in turn led to creditors submitting additional claims for the amount advanced under such instruments. The result being that issuers of such instruments are subject to, in certain circumstances, separate legal proceedings commenced by third-party beneficiaries in response to that initial view of the Officeholders and the Commercial Court.

- **Classes of Creditors:** There has been some uncertainty with respect to the formation of classes of creditors for the purposes of a settlement proposal and voting. The Insolvency Law's implementing regulations contemplate that the classification of creditors must take into account any criteria for such classification that is based on such creditors having similar rights. The determinant therefore being the right to which the claim relates rather than the identity of the creditors.

- **Secured Creditors:** There have been differing views on what constitutes a secured financing with which a creditor would be deemed to be a secured creditor. This has been interpreted by some Officeholders and the Commercial Court, in certain circumstances, to mean those creditors whose claim is secured by a tangible asset only.
  Most notably, there have been differing views on whether an assignment of proceeds (or other forms of receivables) can be considered a secured debt. Whilst the Saudi Central Bank is (the authors understand) of the view that an assignment of proceeds should be a secured debt, particularly in the event that the financing advanced by the creditor was for the purpose of financing the project in respect of which such proceeds relate to. The courts in the Kingdom are yet (to the authors' knowledge) to issue a judgement with respect to their interpretation of this point.

> Since the introduction of the Insolvency Law, a number of issues have arisen with respect to how the Commercial Court and Officeholders are interpreting and applying the law.

- **Related Parties:** The treatment of related parties has been the subject of much contention between debtors and creditors. The Insolvency Law refers to this concept in two contexts — one for the purposes of the so-called "hardening period" (i.e. the period during which the Commercial Court may unwind a transaction within a certain period of time prior to commencement of an option under the Insolvency Law) and the other for the purposes of voting.

- **Voting Thresholds:** How the Insolvency Law determines the voting thresholds for the purposes of ensuring a successful settlement proposal and how related parties are to be considered for the purposes of voting has been the subject of much consideration. This determination has been integral in the formulation of the classes of creditors.

- **Timelines:** Debtors and creditors alike have raised an overarching concern about how the Insolvency Law contemplates a prescribed timeframe for each of the steps, with respect to an option adopted under the Insolvency Law, but that such timeframes are not being adhered to in practice. This has led to such options taking longer than initially anticipated at the time of filing. The Insolvency Law, in general, technically provides little flexibility to extend such timeframes, although in practice such steps are being extended by the Commercial Court through the exercise of its judicial discretion. The Commercial Court has been aiming to achieve a collective balance between the caseload before the Commercial Court, the move to an on-line proceedings platform in lieu of COVID-19 and the interests of each stakeholder.

The Way Forward

Whilst the Insolvency Law has brought with it a legal framework for a modernised insolvency regime in the Kingdom, its interpretation and practical application has been (and continues to be) the subject of much scrutiny, particularly in the context of multi-creditor cross-border debt restructurings. In such cases, creditors have used the insolvency regime in their respective jurisdictions as the benchmark for such scrutiny. However, as with any new law, the Insolvency Law and its stakeholders are adapting to, and in doing so evolving with, such scrutiny — with a view to ultimately achieving the intended policy objective of the Insolvency Law.

If you have questions about this Article, please contact one of the authors listed below:

Salman Al-Sudairi
salman.al-sudairi@lw.com
+966.11.207.2515

Amar N. Meher
amar.meher@lw.com
+966.11.207.2516

The authors would like to thank Abdullah Al-Saeed and Mashal Al-Assaf for their contributions to this article.

Endnotes

[1] The Insolvency Law was promulgated by Royal Decree No. M/50, dated 28/05/1439H. (corresponding to 14 February 2018G.) and amended pursuant to the Royal Decree No. M/89 dated 9/07/1441H. (corresponding to 4 March 2020G.) and its implementing regulations which were issued pursuant to Ministerial Resolution No. 622 (the Implementing Regulations, and together with the Insolvency Law, the Insolvency Law), dated 24/12/1439H. (corresponding to 4 September 2018G.). The Insolvency Law replaces the existing provisions in the Law of Settlement Against Bankruptcy, promulgated by Royal Decree No. M/16, dated 3/09/1416H. (corresponding to 24 January 1996G.) and Chapter 10 of the Companies Law, promulgated by the Royal Decree No. 32, dated 14/01/1350H. (corresponding to 1 June 1931G.).

[2] The Companies Law was promulgated by Royal Decree No. M/3 dated 28/01/1437H. (corresponding to 10 November 2015G.), amended by Royal Decree No. M/79 dated 25/07/1439H. (corresponding to 11 April 2018G.).

[3] Certain provisions of Articles 150 and 181 of the Companies Law have been temporarily suspended by Ministry of Commerce Resolution No. 349, dated 10/04/1442H. (corresponding to 25 November 2020G.). Pursuant to that resolution, the board of managers or (as applicable) directors will have several options, including longer time periods to take the necessary actions when losses of a limited liability company or (as applicable) joint stock company exceed 50% of its share capital. Neither limited liability companies nor joint stock companies will be automatically dissolved pursuant to such Articles.

[4] The Bankruptcy Commission website includes a list of Office Holders (the list can be accessed via this link: https://bankruptcy.gov.sa/en/Pages/officeholder.aspx

[5] Rules Governing Bankruptcy Procedures in Commercial Courts were promulgated by Minister of Justice Resolution No. (6421) dated 21/03/1441H. (corresponding to 18 November 2019G.) (the Rules Governing Bankruptcy Procedures in Commercial Courts).

[6] Suspension of claims is defined under the Insolvency Law as "[t]he suspension of the right to take or continue any procedure or action or file a claim against the [d]ebtor, its [a]ssets or against the guarantor of the [d]ebtor's [d]ebts during a specific period under the provisions of the Law." Suspension of claims essentially prohibits creditors from taking any action against the debtor or its assets with the purpose of enforcing any security within a specified period of time upon applying for the commencement of an option under the Insolvency Law.

[7] Saudi Central Bank Circular No. 42025830 dated 21/4/1442H. (corresponding to 6 December 2020G.).

> "However, as with any new law, the Insolvency Law and its stakeholders are adapting to, and in doing so evolving with, such scrutiny — with a view to ultimately achieving the intended policy objective of the Insolvency Law.

COVID-19 TESTS THE UAE'S INSOLVENCY AND RESTRUCTURING REFORMS

Numerous UAE companies have seen a marked deterioration in their finances as a result of the pandemic. However, extensive government support measures and changes to the 2016 Bankruptcy Law provide a potential lifeline for businesses in difficulty.

In recent years, the United Arab Emirates (UAE) has taken significant steps towards creating a transparent and trustworthy insolvency and restructuring regime that protects creditors and aims to enhance the ease of doing business in the country. The starting point was a new bankruptcy law that came into force in December 2016. Under the law, executives in the UAE can no longer be imprisoned if their companies fail to pay debts, except in carefully defined cases such as the intentional destruction of business records to cause "harm to the creditors".[1]

In addition, the law established a regulatory body, the Financial Reorganisation Committee (FRC), whose responsibilities include supervising out-of-court restructurings of financial institutions and appointing qualified experts to oversee bankruptcy processes.

A succession of large-scale corporate failures since 2018, followed by the combined shock of COVID-19 and falling oil prices, is putting the new legal framework for insolvency and restructuring to the test. The first high-profile case was Dubai-based Abraaj Group, the largest private equity group in the Middle East, which went into liquidation in June 2018 after investors including the Bill & Melinda Gates Foundation raised concerns about the management of its $1bn healthcare fund. In total, the group owed more than $1.2bn to creditors.[2] In July 2019, the Dubai Financial Services Authority fined Abraaj $315m for misleading investors, misusing their funds to pay operational expenses and conducting unauthorised activities.[3]

The next financially distressed UAE company to attract widespread global media attention was NMC Health, based in Abu Dhabi, an international private hospital operator and distributor of clinical products that was listed on the London Stock Exchange (LSE). In April 2020, NMC was placed into administration in the UK and suspended from the LSE after the company disclosed that it owed around $6.6bn to creditors, more than triple the amount it had previously reported.[4]

[1] Bankruptcy Law, Article 197, Clause 1, page 92: https://www.mof.gov.ae/en/lawsAndPolitics/govLaws/Documents/Bankruptcy%20law%20in%20English%2004%20May%202017%20%28ready%20for%20publishing%29.pdf

[2] https://www.economist.com/finance-and-economics/2019/05/18/the-biggest-collapse-in-private-equity-history-will-have-a-lasting-impact

[3] https://www.ft.com/content/c7cd62ce-b29b-11e9-bec9-fdcab53d6959

[4] https://www.arabianbusiness.com/banking-finance/444965-nmc-creditors-said-to-establish-committee-to-coordinate-66bn-debt-talks

Mo Farzadi
Partner, Business Restructuring Services Leader

Mo leads PwC's Business Restructuring Services team in the Middle East and has over 18 years of experience in leading complex financial advisory mandates in the Middle East and Europe.

Following his move from London to the Middle East in late 2010, Mo has helped set up PwC's Business Restructuring Services practice which is now the largest restructuring team in the Middle East region. He is responsible for a team of 30 professionals, including three partners and five directors.

Mo has extensive experience of taking on lead Financial Advisor roles, leading multidisciplinary teams and undertaking large scale and complex debt restructuring/refinancing, independent financial and strategic business reviews, cash flow and liquidity management/review and contingency planning for corporates, lenders and other stakeholders.

Mo is an Insolvency Practitioner and takes formal insolvency appointments in a number of jurisdictions in the Middle East and globally.

Anthony Manton
Partner, Business Restructuring Services

Anthony is a highly respected and extensively experienced restructuring professional. Anthony specialises in diagnosing, advising on and implementing commercial solutions for underperforming, inefficient or distressed organisations.

He has been involved in and led teams across lead Financial Advisor roles, undertaken large scale and complex debt restructurings, cross border insolvency cases, independent financial business reviews, cash flow and liquidity management assignments and contingency planning for corporates, lenders and other stakeholders.

Before moving to the Middle East, Anthony spent the first five years of his professional career in the PwC Australia restructuring team. He has spent the last eight years working extensively within the Middle East, predominately on large, multi-stakeholder and cross border restructuring and insolvency engagements. During this time, he has worked on a number of the region's largest and most high-profile restructuring and insolvency cases, whilst also helping a number of local and international shareholders resolve complex issues in times of crisis or liquidity stress.

The same month, the Central Bank of the UAE ordered the seizure of all the UAE assets of NMC's Indian-born founder B.R. Shetty and his family. The Central Bank also took control of UAE Exchange, a remittance, foreign currency and bill payments company that was part of Shetty's Finablr holding group.

Arabtec Holding, the Middle East's largest construction company, is the latest high-profile corporate failure in the UAE. In September 2020, Arabtec's shareholders voted to liquidate the company after reporting a first-half loss of $216m, accumulated losses of almost $400m and immediate funding needs of around $1bn.[5] Arabtec attributed its unsustainable financial position to the impact of COVID-19, which had caused projects to be stalled or cancelled.

Amid these well-publicised cases, it is easy to lose sight of the fact that COVID-19 has left many smaller UAE companies in distress or on the brink of collapse. The UAE's tourism, retail and hospitality sectors have been especially hard hit by the pandemic. In addition, companies throughout the oil and gas sector have suffered from the fall in oil prices. Meanwhile, the construction and contracting sector has been affected by the same headwinds, with a number of companies that never fully recovered from the 2008/9 global financial crisis left particularly exposed.

COVID-19 support measures to prevent UAE companies going out of business

Since the start of the pandemic, the challenge for the UAE's government, in common with governments worldwide, has been to provide financial life-support for viable companies until some kind of normality returns; in effect, preventing businesses from going bankrupt through no fault of their own. Over the past year, the UAE government has risen to this challenge with a series of measures and initiatives that have helped mitigate the impact of COVID-19 on corporate balance sheets.

In March 2020, as the first wave of COVID-19 swept across the Middle East, the UAE's Central Bank launched the Targeted Economic Support Scheme (TESS), a combination of capital and liquidity measures. The stimulus programme has two main elements. Firstly, there is an AED 50bn ($13.6bn) package that enables all UAE-licensed banks to obtain collateralised loans at zero cost from the Central Bank of the United Arab Emirates to increase liquidity in the market.

Banks that use the facility are strongly encouraged by the UAE's Central Bank to pass on the financial relief by deferring debt repayments for customers who meet certain borrowing criteria, including proving that their performance and cash flows have been damaged by the pandemic.

Secondly, a capital buffer relief scheme has relaxed various capital requirements for UAE-licensed banks to help them absorb the external economic and financial shocks of COVID-19. While the capital conservation buffer remains at 2.5% of risk-weighted assets, banks are allowed to draw up to 60% of this reserve for a maximum period of one year.

During the first three months of the programme, 26 UAE-licensed banks took advantage of the Central Bank facility, buying valuable time for many companies that needed to defer repayments as the pandemic disrupted supply chains, shut down markets and obliged employees to work from home. By November 2020, the central bank estimated that more than 300,000 retail customers, 10,000 small and medium-sized enterprises (SMEs) and 1,500 private-sector companies had benefited from the TESS scheme.[6]

With no immediate end in sight to the pandemic, the bank also announced that TESS would be extended from the original end-of-year deadline to June 2021, providing financially-stretched companies with additional time to produce a convincing, bankable plan of action to meet their debt obligations.

Amendments to the UAE's bankruptcy law to protect businesses in "emergency situations"

The encouraging news for UAE companies and investors is that the legal and regulatory insolvency reforms that began with the bankruptcy law provide a sound, transparent framework for rescuing businesses wherever possible, while protecting the interests of creditors. One measure of the UAE's success in modernising its procedures is the country's rise up the World Bank's annual Ease of Doing Business rankings, which includes "resolving insolvency" as one of its 10 key criteria for assessing national economies.[7] In the latest 2020 survey, the UAE was in 16th place, ahead of any other Middle Eastern country.

On a wider front, other reforms since 2016 in Dubai and Abu Dhabi's respective international financial centre free zones[8] have been informed by an increased focus on procedures that help to protect distressed companies, and then provide a pathway to rescue them through a formal legal process. For example, NMC has utilised the Abu Dhabi Global Market zone's insolvency law to assist its restructuring efforts by obtaining a protective court order to allow it to raise "debtor in possession"-type finance to fund its ongoing operations.

During 2021, as vaccines offer the promise of an end to the pandemic, the UAE is well placed to demonstrate how effective bankruptcy and insolvency laws are critical in underpinning economic recovery. The FRC is set to play a key role, as the arbiter of whether a company has presented sufficient evidence that it deserves to be given a chance to survive, rather than go into liquidation.

[5] https://www.khaleejtimes.com/business/corporate/arabtec-holding-to-proceed-with-liquidation-and-bankruptcy-plan

[6] https://www.centralbank.ae/sites/default/files/2020-11/Bank%20CEOs%20welcome%20TESS%20extension%20by%20CBUAE-En.pdf

[7] https://www.doingbusiness.org/en/rankings

[8] Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM)

In mid-2020, the UAE investment company KBBO Group, with stakes in critical UAE sectors including healthcare, education and consumer products, became one of the first high-profile corporates to apply successfully to the FRC to reorganise its outstanding financial liabilities with local and international lenders. In October 2020, the Dubai-based global engineering and infrastructure contractor Drake & Scull International also applied successfully to the FRC to restructure the company, after accumulating losses of around $1.3bn.[9]

This was precisely the situation afflicting numerous UAE companies, which the government sought to address in November 2020 when it amended the bankruptcy law to provide protection to individuals and businesses facing insolvency due to "emergency situations" – a category that covers the pandemic, but also extends to natural and manmade disasters.

The amendments exempt debtors who can demonstrate that such an emergency has damaged their operations or investments from immediately launching bankruptcy proceedings while they attempt to settle with creditors. If they file an application that is approved by the courts, they are entitled to a grace period of up to 12 months from creditors in order to reach a settlement. During this period, debtors can retain funds that are required to keep their companies running, with creditors having no claim on this reserve. It is too soon to gauge the effect of these amendments, but they should provide more financial breathing space and flexibility for companies on the verge of liquidation because of the pandemic.

The next challenge for the UAE: changing traditional attitudes to corporate failure

Like other Gulf Cooperation Council (GCC) member states, the UAE's need to develop a robust, transparent insolvency and restructuring regime was evident before the pandemic. PwC's latest annual Middle East Working Capital Study[10] found that at the end of 2019, 98% of 433 surveyed companies held an average of only 40 days' cash for operational and interest expenses. Furthermore, 62% of total cash on hand was held by only 10 companies in the survey. In the UAE, the imbalance was even more pronounced: three companies out of 42 listed UAE corporates in the survey held 81% of the total cash on hand at the end of 2019. The average cash on hand that was held by all 42 companies was 71 days, while the average excluding the top three was 60 days.

Many UAE companies masked a continuous deterioration in receivables and inventory performance by successfully extending their payables cycle. Such measures were already risky in the uncertain market conditions that existed across all industry sectors during 2019. In effect, cash-strapped UAE businesses that negotiated extensions were banking on future economic growth to get out of financial trouble. Instead, the double shock of falling oil prices and the COVID-19 downturn pushed many of these companies even further into debt.

At the same time, UAE companies, like their peers across the Middle East, appear to have grasped that disciplined financial and operational management are the key to survival and success in the wake of COVID-19, given the fragility and uncertainty of the regional and global economic outlook. It is striking, for example, that 77% of respondents to PwC's 2021 Middle East CEO survey said that in the wake of the pandemic, they were planning to launch initiatives to achieve cost efficiencies over the next three years. Relevant strategies and measures include: improving inventory management; instilling a cash-conscious culture throughout the company; keeping cash collections under constant scrutiny; and only investing in products and services that can rapidly deliver cash returns.

It is nonetheless inevitable in the current difficult market conditions that many UAE businesses in the coming year will be facing financial challenges. In the past, corporate failure and the threat of a jail sentence for unpaid debts prompted numerous UAE-based executives, especially at smaller firms, to flee the country. Such debts, known as absconders, amounted to $1.4bn in 2015,[11] the year before the bankruptcy law was approved, according to banking industry estimates.

Now, the country has the legislative tools to enable companies on the verge of bankruptcy to seek optimal outcomes with their creditors that save the business from abrupt liquidation. A range of solutions can be explored during an agreed grace period, from a merger to a wholesale restructuring. As a last resort, if liquidation is unavoidable, the UAE's legislative and regulatory regime is designed to ensure that the process is orderly and conserves the maximum value from the defunct company. Critically, the framework aims to achieve a culture shift, away from the previous mentality where bankruptcy was regarded as synonymous with going out of business. The next few years will test how far failing UAE companies and their creditors have come in this transition.

KEY SUMMARY

- The COVID-19 pandemic has placed further pressure on a number of industries and companies across the UAE that were already feeling the effects of financial "stress" from falling oil prices in recent years;
- Proactive and extensive support provided by the UAE government has helped to mitigate and soften the risk in the short term;
- As these government support packages start to come to an end during the first half of 2021, there is widespread expectation that the number of financial restructuring cases in the UAE will increase significantly;
- Since the last big wave of financial restructuring following the global financial crisis, there has been an extensive overhaul of the formal insolvency legislation and framework across the country;
- The efforts by policymakers to bring about positive change to the previous laws will undoubtedly provide a useful tool to help facilitate required financial restructuring cases going forward, and ultimately provide a platform for otherwise good companies to successfully restructure and "rehabilitate";
- Notwithstanding the legislative changes, the companies that not only survive but can also thrive on the back of a "financial shock", such as one brought on by the pandemic, will be those that act now.

[9] https://www.arabianbusiness.com/construction/454698-dubais-drake-scull-says-accumulated-losses-total-13bn

[10] https://www.pwc.com/m1/en/publications/working-capital-2020.html

[11] https://www.reuters.com/article/emirates-bankruptcy-law/new-uae-bankruptcy-law-to-spare-bad-debt-executives-jail-time-idUKL8N1BI1KB?edition-redirect=uk

The world is changing fast. Rethink today. Reinvent tomorrow.

We work alongside businesses across the whole restructuring lifecycle to negotiate great outcomes at speed, finding the optimal solution to financial and operational challenges by reducing risk and protecting value where time and cash are tight.

Mo Farzadi, Partner, Business Restructuring Services Leader

When in a crisis, smart decisions and quick actions need to be taken. Whether you are looking to manage your working capital, restructure your business or realise value for your creditors, our team of experts will be there to help you unlock liquidity and support you across the whole restructuring lifecycle with years of professional experience in dealing with the situational dynamics that a financially challenged business and its stakeholders may face.

Our network of Restructuring and Insolvency experts provide holistic oversight of global best practices, paired with deep local understanding and hands on experience.

Contact us today:

Mo Farzadi
Partner, Business Restructuring Services Leader
E: mo.farzadi@pwc.com

Peter Mayrs
Partner, Business Restructuring Services
E: peter.mayrs@pwc.com

Anthony Manton
Partner, Business Restructuring Services
E: a.manton@pwc.com

pwc.com/me/restructuring

beaumont-capitalmarkets.co.uk
0208 004 3351

Beaumont Capital Markets

大成 DENTONS

Dentons in China